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Supreme Court, U.S.
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No.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1997

TRAVELLERS INTERNATIONAL AG.,

*Petitioners,*

*v.*

TRANS WORLD AIRLINES, INC.,

*Respondent.*

ON PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

## PETITION FOR A WRIT OF CERTIORARI

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## QUESTION PRESENTED

A transfer made within 90 days before a debtor files a bankruptcy petition may be set aside as a preference under section 547(b)(3) of the Bankruptcy Code of 1978 only if it was, among other things, made while the debtor was "insolvent," which is defined in section 101(32) of the Code as a "financial condition such that the sum of [a corporate debtor's] debts is greater than all of such entity's property, at a fair valuation . . . ." 11 U.S.C. § 101(32). The question presented is:

Whether in assessing the insolvency of a debtor actively conducting its business, a court should (a) compare the cash a debtor could raise by liquidating assets with the debtor's existing debts plus new liabilities assumed to arise from that liquidation or (b) compare the contemporaneous fair market values and book values used by the debtor in appraising its assembled assets as a going concern with the sum of its existing debts.

## LIST OF PARTIES AND RULE 29.1 LISTING

The names of all parties appear in the caption. Petitioner Travellers International AG., a Swiss corporation, has been dissolved and is winding up its business. It was a wholly owned subsidiary of Windsor, Inc., a privately held Missouri corporation, which is an affiliate, through common ownership, of Intrav, Inc., a publicly held corporation whose stock is traded on the Nasdaq market.

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## PETITION FOR A WRIT OF CERTIORARI

Travellers International AG. petitions for a writ of certiorari to the United States Court of Appeals for the Third Circuit.

## OPINIONS BELOW

The court of appeals' opinion affirming the bankruptcy court's conclusion that respondent, TWA, was insolvent on the date of the alleged preferential transfer is reprinted as Appendix A and is reported at 134 F.3d 188 (3d Cir. 1998). The district court's opinion is reprinted as Appendix C and is reported at 203 B.R. 890 (D. Del. 1996). The bankruptcy court's opinion is reprinted as Appendix D, and is reported at 180 B.R. 389 (Bankr. D. Del. 1994).

## JURISDICTION

This Court has jurisdiction under 28 U.S.C. § 1254(1). The court of appeals' judgment was entered on January 20, 1998. Petitioner's timely petition for rehearing was denied on March 3, 1998. The court of appeals entered an amended judgment on March 31, 1998.

## STATUTORY PROVISIONS INVOLVED

Section 547(b)(3) of the Bankruptcy Code of 1978, 11 U.S.C. § 547(b)(3):

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property–
>
> . . .
>
> (3) made while the debtor is insolvent[.]

Section 101(32)(A) of the Bankruptcy Code of 1978, 11 U.S.C. § 101(32)(A):

> "insolvent" means–
>
> (A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than the all of such entity's property, at a fair valuation, exclusive of–
>
> (i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and
>
> (ii) property that may be exempted from property of the estate under section 522 of this title[.]

## STATEMENT OF THE CASE

In November 1991, respondent TWA obtained a stay of enforcement of a judgment in favor of petitioner by depositing $13.7 million as security with the clerk of the United States District Court for the Southern District of New York.[1] In its subsequent reorganization proceedings under Chapter 11 of the Bankruptcy Code, TWA sought and obtained a judgment from the United States Bankruptcy Court for the District of Delaware setting aside that deposit as a preferential transfer under 11 U.S.C. § 547(b).[2] On the principal contested issue, the bank-

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[1] The judgment was subsequently affirmed by the Second Circuit. *Travellers Int'l AG. v. Trans World Airlines*, 41 F.3d 1570 (1994). Thus, but for this preference action, the $13.7 million would have been paid to petitioner.

[2] The United States District Court for the District of Delaware, which had jurisdiction over the preference action under 28 U.S.C. § 1334(b), referred it, under 28 U.S.C. § 157(a), to the

[footnote continued]

ruptcy court concluded that TWA was insolvent on the date of the deposit. The United States District Court for the District of Delaware affirmed in part and reversed in part. The United States Court of Appeals for the Third Circuit modified certain of the bankruptcy court's conclusions, but affirmed its holding that TWA was insolvent.

*Pre-Bankruptcy Appraisals.* TWA's contemporaneous pre-bankruptcy records showed it was solvent on the transfer date. On a balance sheet prepared in accordance with generally accepted accounting principles as of October 31, 1991—just four days before the transfer date—TWA's liabilities exceeded its assets by $556 million.[3] But that balance sheet did not place any value on certain off-book assets, to which TWA itself had assigned a fair market value of $1.349 billion in two contemporaneous reports (Appendices H and I) prepared for business purposes in August and November 1991. App. 156a, 162a. In these same contemporaneous reports, TWA also showed that the fair market value of its recorded assets was $354 million greater than the value carried on its balance sheet. *Id.* Thus when the fair market value of TWA's assets was taken into account, and certain agreed adjustments were made, the October 1991 balance sheet established that TWA was solvent by more than $700 million, notwithstanding the serious financial difficulties it was experiencing in common with other airlines.[4]

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bankruptcy judge, who heard and determined the action under authority of 28 U.S.C. §§ 157(b)(1) and (2).

[3]The balance sheet, which both parties used as the starting point for their valuations, is recapitulated in Appendix J at 166a-169a.

[4]The airline industry had suffered losses and was generally depressed in 1991; Pan American and Eastern Airlines had been

[footnote continued]

*Bankruptcy Court.* Because TWA was actively conducting its business on the date of the transfer, as it does today, TWA conceded that it must be valued as a going concern for purposes of determining whether it was insolvent. Knowing that the fair market values it had used in its contemporaneous business dealings would defeat the insolvency element of a preference action, TWA persuaded the bankruptcy court that its solvency must be assessed by determining whether it could have produced sufficient cash by selling all its assets within a "reasonable" period to pay its liabilities existing as of the transfer date as well as those that would arise as a result of the liquidation. The value of its assets would be measured not by their fair market value on the transfer date, but by the amount of cash that they would generate if sold within 12 to 18 months after the transfer date, and the recorded value of its debts would be increased by the liabilities it would incur if it defaulted on all its ongoing leases and contracts and terminated operations.

The bankruptcy court declared that on the transfer date, TWA "was a financially distressed entity in an industry in crisis" (App. 89a) and that "absent a major financial restructuring, [it] was going the way of Eastern

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liquidated in bankruptcy and Continental Airlines was in reorganization. In early 1991, TWA defaulted on its public debt and announced its intention to negotiate a restructuring; the indenture trustees had threatened to seize collateral. Although TWA's December 31, 1991 balance sheet was prepared on a going-concern basis, implying that TWA would "continue operations for some period of time," (trial testimony of Charles Bruce at Tr. 685) its auditors noted that TWA's default "raise[d] substantial doubt about [its] ability to continue as a going concern." *Id.* at 687. Nonetheless, TWA was fully operational throughout its financial difficulties and was vigorously pursuing its business on the transfer date, at which time TWA had enough cash to continue operating for another six to seven months, even if it had paid all of its current debt and lease obligations.

and Pan Am" (App. 94a-95a). The court then used this "finding" as the basis for adopting TWA's valuation method, stating that "in this case a § 547(b)(3) insolvency analysis requires a determination of the amount of funds which could be generated by converting non-cash assets into cash" App. 86a. The court made clear that the insolvency test it was applying necessarily entailed an assumption that TWA would cease all operations and sell its assets. App. 122a, 124a-125a. The court specifically found, without explanation, that 12 to 18 months was the "reasonable time" within which the assets must be assumed to have been sold. App. 88a.

In estimating the value of TWA's assets, the bankruptcy court relied on a litigation report produced by the same expert who had prepared the August and November 1991 appraisals for TWA. Appendix G. In the litigation report, what had previously been described as the assets' "fair market value" became their "Theoretical Value," and the assets' value for purposes of the preference action was called "Sales Value (18 months)." *Compare* Appendices H and I *with* Appendix G. For TWA's aviation assets, this latter value was $1.018 billion (almost 40 percent) less than the fair market value because of the 12- to 18-month time constraint. These values were virtually identical to "liquidation values" provided in the August 1991 report under appraisals that likewise assumed all assets must be sold within 18 months.

The bankruptcy court also agreed with TWA's accounting expert who estimated (Appendix J) the value of TWA's unappraised assets under the same liquidation analysis. Because they could not be readily "sold," assets that had been carried on TWA's balance sheet at $573 million were eliminated altogether. App. 108a, 110a. The eliminated assets included such ordinary current assets as

prepaid expenses and deposits on purchases of flight equipment and the present value of TWA's long-term capital leases, primarily covering aircraft. *Id.* The court then added $1.670 billion in liabilities, including $816 million in liabilities predicated solely on the assumed termination of operations, such as pension termination liabilities, employee severance payments, and union contract termination penalties. App. 120a-127a. Also included was a net increase of $254 million in liabilities based on the assumed termination of TWA's long-term capital and operating leases (App. 120a-121a), and a new liability of $400 million representing the cost of paying post-retirement medical and dental benefits to TWA's present and future retired employees. App. 123a-124a.

Applying this liquidation analysis, the bankruptcy court concluded that TWA was insolvent by $2 billion, with assets of $3.126 billion, and liabilities of $5.125 billion. App. 128a.

*District Court.* The district court affirmed in part and reversed in part. Appendix C. Its decision was superseded by the decision of the court of appeals, which reviewed the bankruptcy court's decision *de novo*.

*Court of Appeals.* The court of appeals affirmed the bankruptcy court's use of TWA's liquidation values for its assets. Appendix A. Although the court declared in the introduction to its opinion that "TWA's assets must be valued at fair market value in the context of a 'going concern' . . .," (App. 3a) its subsequent analysis made clear that it was not adopting fair market value as the "fair valuation" standard.

The court began its analysis by implicitly recognizing that the imposition of a time period within which assets

must be sold results in distress-sale values, explaining that

> the amount that can be realized from the sale of an asset varies as a function of the time period over which the asset must be sold. If a company must sell its assets in a short time period, it may be forced to accept a relatively low price; if it can sell the assets over a longer period, it will be able to hold out for the possibility of a higher price.

App. 11a. The court then accepted TWA's argument that "a 'fair valuation' is best achieved by a hypothetical sale over 12-18 months (TWA's definition of a 'reasonable' time period)." App. 12a.

In affirming the bankruptcy court's valuation of TWA's assets, the court concluded:

> We are satisfied that the bankruptcy court applied the appropriate legal standard in determining the fair valuation of TWA's assets. . . . In light of the size and nature of Trans World Airlines, the bankruptcy court's determination that 12 to 18 months was a "reasonable time" to value TWA's assets is not clearly erroneous. Such a span of time reflects the period in which a diligent administrator, concerned with the interests of TWA's creditors, could inventory, prepare and sell TWA's considerable assets in a reasonable fashion.

App. 15a (citation omitted). Accordingly, the court affirmed the bankruptcy court's finding that on the transfer date, the fair value of TWA's assets was $3.126 billion. App. 16a.

As to liabilities, the court of appeals reversed the bankruptcy court in part, concluding that liabilities "associated with the dissolution of the debtor" were not properly considered. App. 20a. Consistent with that conclu-

sion, the court set aside the bankruptcy court's addition of $816 million in contingent liabilities predicated on termination of operations. Without explanation, however, the court did not disturb other liabilities added by the bankruptcy court, including lease termination liabilities and post-retirement medical and dental expenses, even though these liabilities were also "associated with the dissolution of the debtor." App. 22a (using liabilities the bankruptcy court associated with TWA's liquidation, 120a-121a and 124a). The court of appeals thus upheld so much of the bankruptcy court's opinion as placed the value of TWA's liabilities at $4.308 billion. On this basis, the court concluded that TWA was insolvent at the time of the transfer. App. 22a-23a.

## REASONS FOR GRANTING THE WRIT

This case presents a rare opportunity for the Court to provide guidance on an important issue of bankruptcy law on which the courts of appeals are in conflict and concerning which there is substantial confusion among the circuits. The liquidation valuation method adopted by the court of appeals also conflicts with bankruptcy valuation principles adopted by this Court. This case presents two clear-cut alternative methods for determining insolvency of a going concern: (a) determining whether the cash a debtor could raise in a liquidation would be sufficient to satisfy all its existing debts plus new liabilities assumed to arise from that liquidation or (b) determining whether the fair market values and book values used by the debtor in appraising its assembled assets as a going concern exceed the sum of its debts on the transfer date.

**A. The Case Presents an Important Federal Question.**

"A bankruptcy trustee is armed by statute with a number of powers to avoid prebankruptcy transfers made by the now bankrupt debtor. Probably none of these powers is of more concern to prebankruptcy transferees than the trustee's power to avoid preferential transfers." V. Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713 (1985). A necessary element of a claim that a transfer was preferential is that the debtor was insolvent when the transfer was made. 11 U.S.C. § 547(b)(3). Further, the term "insolvent" is used in no less than 19 provisions of the Bankruptcy Code. Including the preference provisions, a determination of insolvency plays a critical role with respect to the rights and liabilities addressed in ten Bankruptcy Code provisions.[5] In addition, the federal fraudulent conveyance statute, under which the United States may set aside transfers by debtors, also requires the debtor's solvency to be determined by applying a "fair valuation." 28 U.S.C. § 3302(a).

The Court has not directly addressed the proper interpretation of "fair valuation" in the definition of insolvency in the 100 years since that term was first included in the Bankruptcy Act of 1898. As the leading commentator has noted, "the meaning and effect of this term in concrete cases generates a formidable and, on the surface, not always consistent stream of adjudications." 2 COLLIER ON BANKRUPTCY ¶ 101.32[4] at 101-111 to 101-112 (Laurence P. King ed., 15th ed. rev. 1997). The Court's recent observation on an analogous issue of valuation under

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[5] 11 U.S.C. §§ 109(c)(3), 543(d)(1), 545(1)(D), 546(c), 546(d), 547(b)(3), 548(a)(2)(B)(i), 548(b), 553(a)(2)(B)(ii), and 553(a)(3)(B). In other Bankruptcy Code provisions, the term plays a less crucial role. *E.g.*, 11 U.S.C. § 365(b)(2)(A); 11 U.S.C. § 525(a).

the Bankruptcy Code is equally applicable to this fundamental area of bankruptcy law: "a simple rule of valuation is needed to serve the interests of predictability and uniformity." *Associates Commercial Corp. v. Rash*, – U.S. –, 117 S. Ct. 1879, 1886 (1997) (internal quotation omitted).

### B. The Lower Court's Decision Conflicts with Decisions of Other Circuits.

This case provides a glaring example of the inconsistency that exists among the circuits on the proper standard for determining insolvency under the Bankruptcy Code. The Code's insolvency definition requires a financial snapshot of the debtor at a particular time, here the date of an alleged preferential transfer.[6] Where, as here, the debtor is an operating business on that date, the debtor must be evaluated as a going concern: assets are valued as part of an assembled whole on the assumption that the debtor will continue in business. *Danning v. Pharmaceutical Systems. (In re Western Adams Hospital Corp.)*, 609 F.2d 929, 930 (9th Cir. 1979); *Nathanson Bros. v. Atlanta Knitting Mills (In re Nathanson Bros.)*, 65 F.2d 912, 913 (6th Cir. 1933).

The orderly liquidation methodology used below conflicts with the valuation standard used by other courts of appeals. Moreover, the court's approval of a methodology that eliminates significant assets and adds substantial liabilities predicated on the assumption that the debtor

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[6]This definition of insolvency is commonly known as the "balance sheet" test. *E.g., Mellon Bank v. Official Committee of Unsecured Creditors (In re R.M.L., Inc.)*, 92 F.3d 139, 154-55 (3d Cir. 1996); *Jahn v. Fassnacht (In re A. Fassnacht & Sons)*, 826 F.2d 458, 462 (6th Cir. 1987); 2 COLLIER ON BANKRUPTCY ¶ 101.32-[4] at 101-111.

will cease operations conflicts with other circuits' conclusions that an entity that is operating its business at the time of the transfer must be evaluated as a going concern.

Like other circuits, the court below agreed that a contemporaneous balance sheet prepared in the normal course of the debtor's business provided a proper starting point for evaluating the debtor's financial condition. Here, TWA's balance sheet was prepared using generally accepted accounting principles, the hallmark of which is the long-established convention of conservatism, under which possible errors in measuring assets and liabilities are resolved in favor of understating net assets.[7] And like other circuits, the lower court agreed that the value of the debtor's off-book assets should be taken into account.

Most business people and most other circuits would have concluded from the objective contemporaneous evidence of the fair market value of TWA's off-book assets that TWA, as a going concern, was solvent under the Bankruptcy Code's "balance sheet" test. Although the Third Circuit purports to have evaluated TWA as a going concern, it in fact turns the notion of a going-concern valuation on its head. It does not consider the debtor as an operating enterprise, but instead assumes that TWA must sell all of its assets to raise cash and pay creditors. Assets normally considered valuable to an operating enterprise are disregarded, and special liquidation liabilities that would never be accrued by an operating business are added. Essentially, the lower court's liquidation test alters the context of the evaluation from that of an enterprise of assembled assets, here one designed to sell air

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[7] *Shalala v. Guernsey Mem'l Hosp.*, 514 U.S. 87, 100 (1995); *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 542 (1979).

transportation services, to an enterprise of selling used airline assets. No business would likely ever be found solvent under such a test, as is demonstrated by the court of appeals' conclusion that TWA was insolvent, not by the $556 million reflected on its GAAP balance sheet, which excluded off-book assets, but by $1.2 billion after adding those off-book assets. App. 22a.

1. The lower court's decision represents one of at least three standards that the courts of appeals have used to determine the fair value of a going-concern business debtor's assets under the insolvency definition. The inconsistencies can be seen from the following passage from COLLIER:

> Valuation, in general, will signify the reasonable estimate of what can be realized from the assets by converting them into, or reducing them to cash, under carefully guarded if not idealized conditions. "Fair valuation" is not the same as "reasonably equivalent value." It is necessary to look at market value, and not distress value, to reach a fair valuation.

2 COLLIER ON BANKRUPTCY ¶ 101-32[4] at 101-112. Although this passage adopts market value as the preferred measure and disavows distress-sale value, it confuses the issue by asserting that fair value represents "what can be realized from the assets by converting them into, or reducing them to cash," implying that the appraiser must assume the assets are sold to determine their value.

The majority of the courts of appeals that have considered the issue have adopted fair market value as the best measure of "fair value" with respect to a corporate debtor doing business as a going concern. *Briden v. Foley*, 776 F.2d 379, 382 (1st Cir. 1985); *Lawson v. Ford Motor Co. (In re Roblin Indus.)*, 78 F.3d 30, 35-36 (2d Cir. 1996);

*Syracuse Engineering Co. v. Haight*, 110 F.2d 468, 471 (2d Cir. 1940); *Grandison v. National Bank of Commerce*, 231 Fed. 800, 804 (2d Cir. 1916); *In re Lamar Haddox Contractor, Inc.*, 40 F.3d 118, 121 (5th Cir. 1994); *Mizell v. Phillips*, 240 F.2d 738, 741 (5th Cir. 1957); *Covey v. Commercial Nat'l Bank*, 960 F.2d 657, 660 (7th Cir. 1992); *American Nat'l Bank & Trust Co. v. Bone*, 333 F.2d 984, 987 (8th Cir. 1964); *Inter-State Nat'l Bank v. Luther*, 221 F.2d 382, 391 (10th Cir. 1955).[8]

"The term 'fair market value' . . . is a well-established concept." *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 (1994). This Court has defined it as

> the price which it might be expected to bring if offered for sale in a fair market; not the price which might be obtained on a sale at public auction or a sale forced by the necessities of the owner, but such a price as would be fixed by negotiation and mutual agreement, after ample time to find a purchaser, as between a vendor who is willing (but not compelled) to sell and a purchaser who desires to buy but is not compelled to take the particular . . . piece of property.

*Id.* at 538 (internal quotation marks and citation omitted). The fair market value standard is thus realistic and practical, as it is based on actual market conditions as of the date of the valuation.

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[8]The Fourth, Ninth, and District of Columbia Circuits do not appear to have directly addressed the fair valuation issue, although the Ninth Circuit would likely adopt the fair market value standard. *Bennett v. Gemmill (In re Combined Metals Reduction Co.)*, 557 F.2d 179, 185 (9th Cir. 1977). The Eleventh Circuit, although it has not separately addressed the question, is bound by the Fifth Circuit's *Mizell* decision. *See Bonner v. City of Pritchard*, 661 F.2d 1206, 1209 (11th Cir. 1981).

2. Even within those circuits that have adopted fair market value, there are inconsistencies that reflect the confusion generated by the various formulations of the fair valuation standard appearing in the case law. In particular, the First Circuit apparently uses the fair market value standard in a quasi-liquidation analysis, which appraises assets at fair market value, but subtracts "the value of the assets not readily susceptible to liquidation and the payment of debts." *Briden v. Foley*, 776 F.2d at 382. Thus the First Circuit, like the Third Circuit here, ascribes no value to items like prepaid insurance and other prepaid expenses, which normally appear as balance-sheet assets because they have real value to a going concern. These assets are omitted from the solvency analysis simply because they cannot be sold separately, even though their value would undoubtedly be included in the selling price if the business were sold as a going concern.

Similarly, the Seventh Circuit values retail inventory at fair market value *minus* the estimated cost of sales, which normally is not an increment of value on a company's balance sheet, but is instead an operating expense reflected on its income statement. *In re Taxman Clothing Co.*, 905 F.2d 166, 170 (7th Cir. 1990).

3. This Court has made clear that fair market value and forced-sale or liquidation value are antithetical. *BFP v. Resolution Trust Corp.*, 511 U.S. at 537-38. " '[F]air market value' presumes market conditions that, by definition, simply do not obtain in the context of a forced sale." *Id.* at 538. In this case, the lower court abandoned the fair market value standard and aligned itself with the Sixth Circuit in adopting a liquidation analysis that ascribes forced-sale or liquidation values to a going-concern debtor's assets. *See Brown v. Shell Canada, Ltd. (In re Tennessee Chemical Co.)*, 112 F.3d 234, 236 (6th

Cir. 1997).[9] The lower court's decision is also consistent with the First Circuit's quasi-liquidation analysis in that it ascribes no value to assets (such as prepaid insurance and non-refundable deposits on aircraft) that cannot readily be sold separate from the business as a whole.

Although the lower court here initially says TWA's "assets must be valued at fair market value in the context of a 'going concern,' " (App. 3a) the record and the court's analysis disclose that the court did not adopt such a standard.[10] The linchpin of the court's analysis is its reliance on language in a few cases from other circuits, and from the previously quoted passage from COLLIER ON BANKRUPTCY, to the effect that a "fair valuation of assets contemplates a conversion of assets into cash during a reasonable period of time." App. 13a (citing *In re Roblin Indus.*, 78 F.2d at 35-36; *Briden v. Foley*, 776 F.2d at 382; *American Nat'l Bank*, 333 F.2d at 987; *Syracuse Engineering*, 110 F.2d at 471; 2 COLLIER ON BANKRUPTCY ¶ 101.32[4] at 101-116). Ignoring that each of these

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[9] In *Tennessee Chemical*, the court of appeals affirmed "the finding of insolvency based upon the reasoning advanced by the bankruptcy court and affirmed by the district court." *Id.* The bankruptcy court defined fair valuation as "the amount of money the debtor could raise from its property in a reasonably short period of time, but not so short as to approximate a forced sale, if the debtor operated as a reasonably prudent businessman with his interests in mind, especially a proper concern for the payment of his debts." *Brown v. Shell Canada, Ltd. (In re Tennessee Chemical Co.)*, 143 B.R. 468, 474 (Bankr. E.D. Tenn. 1992). Like the Third Circuit here, the Sixth Circuit failed to explain how the imposition of a time constraint can result in anything other than a forced sale.

[10] Indeed, in its five-page analysis of the fair valuation standard, the court mentions the term "market value" only once, and then, again, only by way of introduction. App. 3a. Similarly, the court does not even mention, much less discuss, TWA's own contemporaneous estimates of its assets' fair market value.

authorities expressly adopts fair market value as the standard for fair valuation, the court focuses on the phrase "reasonable period of time" to adopt a valuation standard that assumes a hypothetical sale of all of a debtor's assets that commences on the date of the transfer and ends at some "reasonable time" thereafter.

The result is a liquidation, or forced-sale, standard. A valuation that is premised on the assumption that assets *must* be sold is not a value resulting from a transaction between a willing buyer and a willing seller. *Cf. BFP v. Resolution Trust Corp.*, 511 U.S. at 537. Further, the court of appeals implicitly recognizes the dramatic effect that the time constraint built into its "reasonable time" limitation has on an asset's fair market value. App. 11a. Elsewhere the lower court recognizes that its reasonable time limitation negatively affects fair market value, "We disagree with Travellers' view that . . . a fair valuation implicates a hypothetical sale absent *time pressures.*" App. 15a (emphasis added). And the court of appeals expressly describes its standard as a liquidation standard: "fair valuation does not preclude a continuing business from valuing its assets in contemplation of a reasonable time for their *liquidation.*" *Id.* (emphasis added).

### C. The Court of Appeals' Decision Conflicts with Decisions of This Court.

Although the Court has not addressed the proper standard for determining the fair value of a debtor's assets under the bankruptcy definition of insolvency, it has decided several cases under the bankruptcy laws' preference and fraudulent conveyance provisions raising related issues. The court of appeals' decision here is inconsistent with principles enunciated in those decisions.

In *Pirie v. Chicago Title & Trust Co.*, 182 U.S. 438 (1901), the Court considered the preference provisions of the Bankruptcy Act of 1898, which first set forth the fair valuation standard. The Court noted that the 1898 Act replaced the 1867 Act's equity test of insolvency—an inability to pay debts as they become due—with the balance sheet test, making proof of insolvency more difficult:

> Inability to pay debts in the ordinary course of business usually accompanies an insufficiency of assets. It may not, of course. At times a debtor's property, though amply sufficient in value to discharge all of his obligations, may not be convertible without sacrifice into that form by which payments may be made. The law regards that possibility. In this there is indulgence to the debtor, and through him to preferred creditors.

182 U.S. at 451.

The test adopted here by the Third Circuit does not grant "indulgence to the debtor" with respect to the possibility that its property "may not be convertible without sacrifice into that form by which payments may be made." To the contrary, the lower court's test expressly takes into account the debtor's impecunious situation by assuming that a debtor must sell all of its assets within a predetermined period, even though such a sale necessarily entails sacrifice, and even if some valuable assets cannot be sold at all.

The Bankruptcy Act of 1898 defined a preference as a transfer that if enforced would, among other things, "enable any one of [the debtor's] creditors to obtain a greater percentage of his debt than any other of such creditors of the same class." Former 30 Stat. 544 (1898)

as amended, 32 Stat. 799 (1903). In *Palmer Clay Products Co. v. Brown*, 297 U.S. 227 (1936), the recipient of a preferential transfer argued that "a creditor who receives a part payment of his claim does not receive a preference . . . [if] the debtor's assets at the time of the payment would, if then liquidated and distributed, be sufficient to pay all the creditors of the same class an equal portion of their claims." The Court rejected this argument, holding that the preferential effect of a transfer is to be determined by "the actual effect of the payment as determined when bankruptcy results." *Id.* The Court reasoned:

> We may not assume that Congress intended . . . to introduce the impractical rule of requiring the determination, as of the date of each [preferential] payment of the hypothetical question: What would have been the financial result if the assets had then been liquidated and the proceeds distributed among the then creditors?

*Id.*

Although the Third Circuit asserts that its valuation standard provides a "realistic framework" (App. 11a), *Palmer Clay Products* makes clear that a financial analysis that requires a hypothetical liquidation of the debtor's assets is simply impractical. *See also BFP v. Resolution Trust Corp.*, 511 U.S. at 538. And, to the extent that market conditions are relevant to the lower court's standard, its requirement that the assets be sold within a "reasonable time"—which necessarily requires predictions of market conditions for some time after the transfer—makes the court of appeals' test even more speculative and impractical.

As noted, the Third Circuit initially states that TWA's assets must be ascribed their fair market value. App. 3a. The test it adopts, however, plainly conflicts with this Court's definition of fair market value in *BFP v. Resolution Trust Corp.*, which makes clear that the essence of fair market value is the absence of a compulsion to sell and time constraints. A debtor that must sell all of its assets to pay creditors is not a seller that is "willing (but not compelled) to sell." 511 U.S. at 537-38. And requiring that the seller must sell within some preordained "reasonable time" determined on the basis of the competing interests of creditors is not one that contemplates that the seller has "ample time to find a purchaser." *Id.*

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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April 16, 1998

# APPENDIX

Supreme Court, U.S.
FILED

97-1699 APR 16 1998

No. OFFICE OF THE CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1997

TRAVELLERS INTERNATIONAL AG.,

*Petitioners,*

*v.*

TRANS WORLD AIRLINES, INC.,

*Respondent.*

ON PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

## APPENDIX TO
## PETITION FOR A WRIT OF CERTIORARI

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## APPENDIX A

Filed January 20, 1998

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 97-7037 and 97-7082

IN RE: TRANS WORLD AIRLINES, INCORPORATED,
*Debtor*

TRAVELLERS INTERNATIONAL AG,
*Appellant/Cross-Appellee*
*in Appeal No. 97-7037*

v.

TRANS WORLD AIRLINES, INCORPORATED;
OFFICIAL COMMITTEE OF
UNSECURED CREDITORS FOR
TRANS WORLD AIRLINES

Trans World Airlines, Incorporated
*Appellant/Cross-Appellee*
*in Appeal No. 97-7082*

On Appeal from the United States District Court
for the District of Delaware
(D.C. No. 95-cv-00031)

Argued Friday, September 12, 1997

BEFORE: MANSMANN, NYGAARD and
GARTH, *Circuit Judges*

(Opinion filed January 20, 1998)

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## OPINION OF THE COURT

GARTH, *Circuit Judge*:

The sole issue we must resolve in this appeal is whether TWA was insolvent on November 4, 1991 so that the transfer of certain monies to a judgment creditor within

90 days of TWA's petition for bankruptcy constituted a preference. Our analysis of TWA's insolvency depends on how TWA's assets and liabilities should be valued.

We conclude that TWA's assets must be valued at fair market value in the context of a "going concern" and that its liabilities should be measured at face value. Inasmuch as we agree with the bankruptcy court's calculations, albeit with minor qualifications, we hold that on the date in question, TWA was insolvent. Accordingly, any transfer of TWA's monies to Travellers falls within the preference statute, 11 U.S.C. § 547(b).

We will reverse the district court's order, which had reversed the insolvency holding of the bankruptcy court, and direct the district court to remand this case to the bankruptcy court for proceedings consistent with our opinion.

## I.

On October 12, 1991, the United States District Court for the Southern District of New York entered a judgment in the amount of $12.3 million in favor of Travellers International AG ("Travellers") against Trans World Airlines, Inc. ("TWA"). On November 4, 1991, TWA obtained a stay of enforcement of the judgment by depositing $13.7 million in cash with the clerk of the court. Eighty-eight days after the deposit was made, on January 31, 1992, TWA filed a petition for reorganization in the United States Bankruptcy Court for the District of Delaware under Chapter 11 (11 U.S.C. § 101 *et seq.*). Subsequently, TWA filed a complaint against Travellers in the United States Bankruptcy Court for the District of Delaware, seeking a declaration that the $13.7 million deposit was a preferential transfer which was

voidable under 11 U.S.C. § 547(b).[1] *See Travellers Int'l AG v. Robinson*, 982 F.2d 96, 97 (3d Cir. 1992).

A. The Bankruptcy Court Proceedings

The bankruptcy court held a four day bench trial in February 1994 to determine whether the deposit was indeed a preferential transfer. *See In Re Trans World Airlines, Inc.*, 180 B.R. 389 (Bankr. D. Del. 1994). In particular, the court focused its attention on the statutory requirement that TWA was insolvent on the day of the transfer. *See* 11 U.S.C. § 547(b)(3). Following the code's guidance that a corporation is insolvent when "the sum of such entity's debts is greater than all of such entity's

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[1] 11 U.S.C. § 547(b) (1993) states:

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property–

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made–

(A) on or within 90 days before the date of the filing of the petition;

or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if–

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

property, at a fair valuation," 11 U.S.C. § 101(32)(A),[2] the bankruptcy court heard evidence by experts hired by both TWA and Travellers on the value of TWA's assets and liabilities.

1. Travellers' Arguments

Travellers, together with its expert Global Aviation Associates, Ltd. ("Global"), offered testimony that TWA's assets exceeded its liabilities by almost two billion dollars, and thus that the company was solvent. Global based its "fair valuation" of TWA's assets on their market value assuming that TWA was not compelled to sell the assets under any time constraint. Applying this methodology, Global valued TWA's operating assets at $4,162,273,000. *See* 180 B.R. at 421. Combining this with the cash, cash equivalents, accounts receivable, and other investments owned by the company, Travellers argued that the value of the company's assets totaled $5,298,373,000.

Turning to TWA's liabilities, Travellers contended that § 101(32)(A) called for a "fair valuation" of TWA's liabilities, which Travellers insisted translated into a fair market valuation of TWA'S publicly traded debt. As a result, Travellers' expert testified that TWA's debt obliga-

---

[2] 11 U.S.C. § 101(32)(A)(1993) states in full:

"insolvent" means—

(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of—

(i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and

(ii) property that may be exempted from property of the estate under section 522 of this title[.]

tions amounted to $662,898,000.[3] With respect to TWA's additional liabilities, Travellers' expert testified that the value of TWA's aircraft lease obligations was $813,604,-000; pension plan liabilities, $219 million; taxes, $949.7 million; and other liabilities, $947.4 million. Travellers calculated the sum of TWA's liabilities to be $3,593,000,-000.

Inasmuch as TWA's assets, if valued at $5,298,373,-000 exceeded its liabilities at $3,593,000,000, Travellers urged the bankruptcy court to find that TWA was solvent.

### 2. TWA's Arguments

TWA and its experts, Avmark Inc. ("Avmark"), offered very different valuations of both assets and liabilities. According to TWA's calculations, TWA was insolvent on November 4, 1991, the date of the transfer to the escrow account, because TWA's liabilities exceeded assets by as much as three billion dollars. Avmark based its "fair valuation" of TWA's assets on the amount realizable from the assets following a hypothetical sale of the assets within a reasonable time period. Referring to 12-18 months as a reasonable time period, Avmark concluded that the overall value of TWA's assets was $2,561,366,000. *See* 180 B.R. at 404.

As to the company's liabilities, TWA contended that the fair valuation prescription in 11 U.S.C. § 101(32)(A) did not apply to liabilities. TWA thus asked the court to consider the face value of the company's debt, rather than the much lower market value urged by Travellers, in determining the company's insolvency. TWA's calculation

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[3] This figure is far less than the "face" value of TWA's public debts, $1,776,752.000, which we assume represented the net present value of TWA's debts as of the date of the transfer.

of the company's liabilities also included an extra $634,-814,000 of what it termed contingent liabilities, as well as up to $576,000,000 of pension plan liabilities. These additional liabilities represented costs to which TWA would be subject if it had ceased operating soon after November 4, 1991: they included $138.8 million payable to two of TWA's unions, $214.8 million for severance payments pursuant to contractual obligations, and $248.2 million in wind down expenses. TWA urged the court to consider these liabilities in light of the high likelihood as of November 4, 1991 that TWA would soon cease operations. Combined with $370 million in tax liability, medical/dental benefits totaling $400 million, and almost one billion dollars of other liabilities, the liability figure urged by TWA totaled between five and five and a half billion dollars.

Because this figure exceeded the asset valuation of $2,561,366,000, TWA urged that the company was insolvent.

### 3. The Bankruptcy Court's Rulings

In an extensive opinion, the bankruptcy court agreed with TWA's conclusion that the company was insolvent. Addressing the valuation of assets, the court agreed with TWA that a "fair valuation" of assets would be found by calculating the amount that would be realized by converting non-cash assets into cash over a reasonable time frame. *See* 180 B.R. at 411. The court found Travellers' position that asset valuations exist independently of an actually realizable amount to be unrealistic. As such, the court largely adopted Avmark's asset valuations. Altogether, the bankruptcy court disagreed with TWA's asset valuations in only three relatively minor categories: the company's investment in affiliates, the value of the com-

pany's gates outside of St. Louis and JFK, and the measure of the company's accounts and other receivables. In these three areas, the court found that for various factual reasons, TWA's figures were too low, and substituted Travellers' figures. The court concluded that the proper valuation of TWA's assets was $3,125,811,000.

Turning to the company's liabilities, the bankruptcy court first considered whether TWA's public debt should be measured at market value or at face value. The court concluded that face value was the proper guide for two reasons. First, the text of 11 U.S.C. § 101(32)(A) suggested that the "fair valuation" requirement did not apply to debts. Second, the court opined that valuing debts at market value would, among other things, create an unprincipled distinction between the treatment of private and public debt. *See* 180 B.R. at 423-24. The court thus adopted the face value figure of the company's debts urged by TWA, $1,776,752,000.

As to the liabilities incurred by the company's aircraft leases, the court accepted TWA's figure of $595 million because it appeared to be the only probative evidence put forward by the two parties. TWA's view that the medical and dental benefits obligations amounted to $400 million was also accepted. Travellers had argued that this liability should be zero because TWA's benefits program had created an offsetting good will asset among its employees. This argument was rejected on the ground that the good will was not a saleable asset and had no market value. Having largely accepted TWA's asset figures, the bankruptcy court in turn adopted TWA's estimate of its tax liability, $370 million, and also adopted Travellers' largely uncontested figure for 'other' liabilities, $947,-381,000.

The final liabilities to be determined were TWA's pension plan obligations and what TWA termed 'contingent' liabilities. The court adopted TWA's view that these liabilities were to be assessed in light of the likelihood that TWA was on the verge of going out of business on November 4, 1991. As a result, the court calculated the liabilities that TWA would incur if the company ceased its operations. This added $634,814,000 of contingent liabilities arising from the hypothetical liquidation to the overall liability figure, and also raised the pension plan liability from $219.4 million to $401 million. Altogether, the bankruptcy court decided that TWA's liabilities totaled $5,124,947,000, which exceeded the asset figure of $3,125,811,000 by two billion dollars. Thus, the bankruptcy court held that TWA was insolvent, and that the transfer of $13.7 million was voidable as a preference.

B. The District Court Proceedings

On appeal, the United States District Court for the District of Delaware affirmed in part, reversed in part, and remanded to the bankruptcy court. *See Travellers Int'l AG v. Trans World Airlines, Inc. (In re Trans World Airlines, Inc.)*, 203 B.R. 890 (D. Del. 1996). The district court agreed with the bankruptcy court's position that the proper legal test for a fair valuation of the company's assets should be based on the amount that could be obtained if the assets were sold in a reasonable time. *See id.* at 895. Concluding that the bankruptcy court's adoption of a 12 to 18 month period as a reasonable time frame was a factual matter, and that none of the bankruptcy court's factual determinations relating to assets was clearly erroneous, the court affirmed the bankruptcy court's determination that the company's liabilities were $3,125,811,000.

On the liability side, however, the district court disagreed with the bankruptcy court's legal conclusion that the "fair valuation" requirement of 11 U.S.C. § 101(32)(A) did not apply to the company's debts. Relying largely on *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 648 (3d Cir. 1991), the district court held that both assets and liabilities were subject to the fair valuation requirement. Accordingly, the court concluded that the bankruptcy court's decision to value the public debt at face value was error. *See* 203 B.R. at 897-98. In all other respects, the court agreed with the bankruptcy court's legal analysis, and found that the bankruptcy court's factual conclusions were not clearly erroneous. Thus, the district court reversed the portion of the bankruptcy court's decision relating to liabilities, and remanded with instructions to conduct a fair valuation of TWA's liabilities.

The instant appeal and cross-appeal followed.

## II.

We exercise jurisdiction to review this appeal pursuant to 28 U.S.C. §§ 1291 and 158(d). *See Porter v. Mid-Penn Consumer Discount Co. (In re Porter)*, 961 F.2d 1066, 1072 (3d Cir. 1992). Whether a company is insolvent under the Bankruptcy Code is considered a mixed question of law and fact. *See Moody v. Security Pacific Business Credit*, 971 F.2d 1056, 1063 (3d Cir. 1992). While factual findings are reviewed only for clear error, our choice and interpretation of legal precepts and its review of "the trial court's application of those precepts to the historical facts" is plenary. *Universal Minerals, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 103 (3d Cir. 1981).

## III.

### A. Asset Valuations

The first question we must answer is how to measure properly a "fair valuation" of TWA's assets according to 11 U.S.C. § 101(32)(A). Because liquidation in bankruptcy was not clearly imminent on the date of the challenged transfer, we concern ourselves with how to achieve a fair valuation of TWA's assets on a "going concern" basis. *See Moody*, 971 F.2d at 1067.

In the century that has passed since the enactment of the Bankruptcy Act of 1898, the courts have offered various statements describing how to achieve a fair valuation of assets for a going concern. The cases generally direct us to look at "market value" rather than "distress value," but then also caution that the valuation must be analyzed "in a realistic framework" considering amounts that can be realized "in a reasonable time" assuming a "willing seller" and a "willing buyer." *See, e.g., BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537, 114 S. Ct. 1757, 1761 (1994); *Syracuse Engineering Co. v. Haight*, 110 F.2d 468, 471-72 (2d Cir. 1940). Although these statements are helpful in many cases, they fail to resolve squarely the question of law that is before us. That question centers around a disagreement about the appropriate time frame under which a hypothetical sale of assets must take place to achieve a valuation that is "fair" for a going concern.

Logic and common sense inform us that the amount that can be realized from the sale of an asset varies as a function of the time period over which the asset must be sold. If a company must sell its assets in a short time period, it may be forced to accept a relatively low price; if it can sell the assets over a longer period, it will be able to hold out for the possibility of a higher price. TWA's

position, accepted by both the bankruptcy court and the district court, is that a "fair valuation" is best achieved by a hypothetical sale over 12-18 months (TWA's definition of a "reasonable" time period). That is, the value of the assets is to be measured by the sales price that could be attained if there were a period of 12-18 months to sell off the assets. Travellers, however, argues that the proper time period is substantially longer: so long, in fact, that the assets should be valued without regard to the pressures of time. In other words, Travellers maintains that the value of the assets is to be measured by the price that could be attained if TWA could hold out for as long a period as necessary to receive a 'full' price on its assets.

The parties enlist a substantial body of case law in support of their respective positions. TWA bases its position on a voluminous line of cases stating that fair valuation involves a value that can be made available for payments of debts within a reasonable period of time. *See, e.g., Syracuse Engineering Co.*, 110 F.2d at 471; *Briden v. Foley*, 776 F.2d 379, 382 (1st Cir. 1985); *American Nat'l Bank & Trust Co. v. Bone*, 333 F.2d 984, 987 (8th Cir. 1964). TWA argues that 12-18 months is a reasonable period of time, such that the use of a 12-18 month sale scenario by the bankruptcy court was proper.

Travellers, on the other hand, relies on cases stating that fair valuation of a going concern implicates a fair market valuation. *See Lawson v. Ford Motor Co. (In re Roblin Indus.)*, 78 F.3d 30, 36 (2d Cir. 1996); *Briden*, 776 F.2d at 382. Travellers then argues that a fair market valuation is achieved by a sale without regard to the pressures of time. *See BFP*, 511 U.S. at 537-38, 114 S. Ct. at 1761-62; *Duncan v. Landis*, 106 F. 839, 858-59 (3d Cir. 1901). Accordingly, Travellers construes the 12-18 month sale scenario used by the bankruptcy court and

district court as a forced sale, which undervalued TWA's assets and led to an improper conclusion that TWA was insolvent on the date of the transfer.

We begin our analysis by recognizing the overwhelming body of authority that makes clear that a fair valuation of assets contemplates a conversion of assets into cash during a reasonable period of time. *See, e.g., In re Roblin Indus.*, 78 F.3d at 35-36; *Moody*, 971 F.2d at 1068; *Briden*, 776 F.2d at 382; *American Nat'l Bank & Trust Co.*, 333 F.2d at 987; *Syracuse Engineering Co.*, 110 F.2d at 471; 2 *Collier on Bankruptcy* ¶ 101.32[4] at 101-116 (15th ed. Rev. 1997).[4] The question then becomes how to construe whether a given time period is reasonable. As previously indicated, TWA maintains that a reasonable time is the period of time that a company such as TWA might reasonably require to sell off its assets in order to pay off its debts and attempt to satisfy its creditors. Travellers disagrees with TWA's approach, and asserts that a reasonable period is the time that an active

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[4]This interpretation of the fair valuation requirement followed naturally from the text of the insolvency definition in effect from 1898 until 1978. During that period, the Act stated that a "person shall be deemed insolvent . . . whenever the aggregate of his property . . . shall not at fair valuation be sufficient in amount to pay his debts." 11 U.S.C. § 1(19) (repealed 1978). This text suggests a conversion-to-cash valuation.

In contrast, the current version states only that insolvency is a "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." 11 U.S.C. § 101(32)(A)(1993). Although the conversion-to-cash methodology is less obvious from the current text, courts have uniformly treated the current version of the statute as being identical in relevant part to the earlier version, and we will do the same. *See* S. Rep. No. 95-989, 85th Cong., 2d Sess. (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5811 ("The definition of 'insolvent' in paragraph [(32)] is adopted from section 1(19) of current law. . . . It is the traditional bankruptcy balance sheet test of insolvency.").

company might reasonably take to sell its assets in the typical course of business at the highest available price.

We believe that the proper point of reference for determining a "reasonable" time period in the case of § 101(32)(A) should begin with the financial interests of the creditors. *See Syracuse Engineering Co.*, 110 F.2d at 471. The reasonable time should be an estimate of the time that a typical creditor would find optimal: not so short a period that the value of the goods is substantially impaired via a forced sale, but not so long a time that a typical creditor would receive less satisfaction of its claim, as a result of the time value of money and typical business needs, by waiting for the possibility of a higher price. *Cf. id.* This test satisfies the requirement of a fair valuation because it identifies, as best it can, the equilibrium point between the two competing concerns of creditors: the desire to maximize the dollar figure from the assets to be sold, and the desire to have the assets sold off quickly to satisfy creditors' claims sooner rather than later. The competing view that fair valuation contemplates a hypothetical sale without regard to the pressures of time fails in light of contrary authority. *See Briden*, 776 F.2d at 382 ("Asset valuation . . . should be reduced by the value of the assets not readily susceptible to liquidation and the payment of debts"); *Stern v. Paper*, 183 F. 228, 230-31 (D.N.D. 1910) ("[F]air valuation . . . means a value that can be made promptly effective by the owner of property to pay his debts.") (quotations omitted).

Contrary to the assertions of Travellers, *Duncan v. Landis*, 106 F. 839 (3d Cir. 1901), does not support Travellers' position that the hypothetical sale must take place absent time pressures. In *Landis*, this court evaluated a set of jury instructions concerning how to achieve a fair valuation of a debtor's assets. The district court had

instructed the jury using the traditional equity test for insolvency, that a debtor was solvent only if the debtor was able to meet all obligations when they became due. This court reversed, holding that a fair valuation of assets was not achieved when a debtor was forced to sell assets "at once" on the date the debt matured. *Id.* at 859.

We disagree with Travellers' view that *Landis* holds that a fair valuation implicates a hypothetical sale absent time pressures. As we read *Landis*, it presages the view we have espoused: that fair valuation does not preclude a continuing business from valuing its assets in contemplation of a reasonable time for their liquidation. Thus, whereas the district court in *Landis* required insolvency to be measured by the value of those assets available at the time the debt became due, the court of appeals found that formula to be in error. As our court instructed then, the application of such a formula to measure the value of the debtor's assets would permit creditors "to take advantage of the necessities and embarrassments of the [debtor] in order to procure" the assets at a price less than their fair value. *Id.* at 858.

We are satisfied that the bankruptcy court applied the appropriate legal standard in determining the fair valuation of TWA's assets. *See In re Trans World Airlines*, 180 B.R. at 412, 412 n.30. In light of the size and nature of Trans World Airlines, the bankruptcy court's determination that 12 to 18 months was a "reasonable time" to value TWA's assets is not clearly erroneous. Such a span of time reflects the period in which a diligent administrator, concerned with the interests of TWA's creditors, could inventory, prepare, and sell TWA's considerable assets in a reasonable fashion. Further, we agree with the district court that none of the remaining factual findings by the bankruptcy court relating to assets were clearly

erroneous. Consistent with the district court's holding that affirmed the bankruptcy court's asset valuation, we hold that TWA's assets as of November 4, 1991 were worth $3,125,811,000.

B. Liability Valuations

Next we must decide how to value TWA's liabilities under 11 U.S.C. § 101(32)(A). To decide this issue we must address the extent to which the valuation of liabilities under the Bankruptcy Code should be based upon actual market conditions faced by the debtor. In particular, we must resolve two legal questions: first, whether TWA's publicly traded debt should be measured at face value or market value, and second, whether liquidation costs should be included as contingent liabilities. Then, we must review one factual question: whether the bankruptcy court was correct in finding that TWA's debt was not reduced by one billion dollars under an agreement between TWA and its creditors.

1.

The first question is whether TWA's publicly traded debt should be measured at its face value of $1,776,752,000, or its market value of $662,898,000. Both TWA and Travellers assume, as did the bankruptcy court and district court, that the question of whether to use face value or market value hinges upon a question of statutory interpretation. 11 U.S.C. § 101(32)(A) states that insolvency is the "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." The parties indicate that if we agree with the district court that "fair valuation" in § 101(32)(A) modifies both "property" and "debts," then we should adopt the market value figure for TWA'S debt. If, on the other hand, we agree with the bankruptcy court

that "fair valuation" as found in the statute modifies only "property," then our insolvency calculations should utilize the face value of TWA's publicly traded obligations.

Travellers argues that § 101(32)(A) demands a market valuation because the phrase "fair valuation" in § 101(32)(A) modifies both "property" and "debts," such that the fair market valuation used for assets should apply equally to liabilities. For support, Travellers points to statements made by this court and others suggesting that the fair valuation requirement of § 101(32)(A) applies to TWA's debts. *See, e.g., Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 648 (3d Cir. 1991) ("The debtor's assets and liabilities are tallied at fair valuation to determine whether the corporation's debts exceed its assets."); *Briden*, 776 F.2d at 382 (noting that the insolvency definition "focuses on the fair market value of the debtor's assets and liabilities").

However, TWA maintains that the appropriate valuation of TWA's public debt is its face value rather than its market value because the requirement of a "fair valuation" in § 101(32)(A) does not apply to debts and should not be construed to do so. For support, TWA points to the text of the insolvency definition that was in effect until 1978.[5] According to TWA, the pre-1978 statute makes clear that the fair valuation requirement applies to properties but not to debts. Second, TWA points to the insolvency definition that applies to partnerships, codified at 11 U.S.C. § 101(32)(B).[6] Because this defi-

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[5] *See* note 4, *supra*.

[6] 11 U.S.C. § 101(32)(B)(1993) states that "insolvent" means:

> (B) with reference to a partnership, financial condition such that the sum of such partnership's debts is greater than the aggregate of, at a fair valuation—

[footnote continued]

nition applies the fair valuation standard only to property (assets), and there is no reason to think that partnerships and corporations should be treated differently in this respect, TWA argues that its debt is not subject to a fair valuation requirement. Accordingly, TWA argues that its debt should be considered at its face value.

We agree with TWA that we must consider the face value of TWA's publicly traded debt rather than the market value. This follows from our determination that we must treat TWA as a "going concern." *See Moody*, 971 F.2d at 1067. Because we treat TWA as a going concern, we cannot consider the market's devaluation of TWA's debt resulting from the possibility as of the date of the transfer that TWA would cease operations and be unable to satisfy its promises. It is this devaluation that creates the difference between the face value figure urged by TWA and the market value figure Travellers would have us adopt: the former represents the net present value of TWA's obligations, while the latter represents the net present value of TWA's obligations but discounted by the likelihood that TWA will be unable to pay its debts in full.

Thus, even accepting the dictum in *Metro Communications* stating that we must fairly value liabilities, *see* 945 F.2d at 648, in this context we do not interpret the term "fair valuation" to mean fair market valuation. Because our going concern methodology precludes us

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(i) all of such partnership's property, exclusive of property of the kind specified in subparagraph (A)(i) of this paragraph; and

(ii) the sum of the excess of the value of each general partner's nonpartnership property, exclusive of property of the kind specified in subparagraph (A) of this paragraph, over such partner's nonpartnership debts[.]

from devaluing TWA's debt based on creditors' perceptions of TWA's viability, a fair valuation of TWA's public debt is the face value of that debt. *See Covey v. Commercial Nat'l Bank*, 960 F.2d 657, 660 (7th Cir. 1992) (holding that valuation of debt must be made from the perspective of the debtor, rather than the perspective of a third party creditor).[7] Accordingly, we hold that the proper figure for TWA's publicly traded debt is the debt's face value of $1,776,752,000.

2.

We proceed to consider whether the bankruptcy court erred in including amongst TWA's liabilities various costs that TWA would incur if TWA were to cease operations within 12-18 months of the date of the transfer. The bankruptcy court deemed it proper to consider the costs that TWA would suffer if it were to cease operations because courts must consider "contingent liabilities" in their calculations of liability in an amount discounted by the probability that the contingency will occur. *See In re Trans World Airlines*, 180 B.R. at 426-27. The bank-

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[7] As the bankruptcy court noted, anamalous results would occur if we allowed liabilities to be valued based on the debtor's financial position:

> If holders of claims are fully informed of the debtor's affairs and the asset values are less than the face amount of the claims, they would never value their claims at more than the value of the assets. Likewise, the fully informed debtor would never be willing to pay claimants more than claimants would be willing to take. Thus, the value of the claims would never exceed the value of the assets and insolvency could never occur.

180 B.R. at 424. *See also Covey*, 960 F.2d at 660 ("The beneficiary of a guarantee never values that obligation at more than the issuer's gross assets, and if other claims (say, secured debts) stand ahead of this one, the beneficiary does not value the guarantee at more than the issuer's net assets.").

ruptcy court reasoned that under the 12-18 month sale scenario it used to value TWA's assets, the liabilities contingent upon TWA's projected dissolution would become fixed. The bankruptcy court was also influenced by the probability as of the date of the transfer that TWA would soon be forced to cease operations. Accordingly, the bankruptcy court held that it was proper to include the full costs of TWA's dissolution as liabilities, even though TWA was not liquidating on November 4, 1991. These liabilities totaled $816.4 million, and consisted of $248.2 million in wind down expenses, $214.8 million for severance payments, $181.6 million in additional pension plan liabilities, $138.8 million payable to TWA's unions, and $33.1 million of COBRA obligations.[8]

We agree with the bankruptcy court that it is proper to consider contingent liabilities when evaluating the insolvency of a corporation pursuant to 11 U.S.C. § 101 (32)(A). *See Mellon Bank, N.A. v. Official Comm. of Unsecured Creditors (In re R.M.L., Inc.)*, 92 F.3d 139, 156 (3d Cir. 1996); *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 200 (7th Cir. 1988); *Syracuse Engineering Co. v. Haight*, 97 F.2d 573, 576 (2d Cir. 1938) (L. Hand, J.). However, we cannot agree that costs associated with the dissolution of the debtor can be included under that rubric. Indeed, it is the antithesis of a "going concern" valuation to include such costs. *See* 2 *Collier on Bankruptcy* ¶ 101.32[4] at 101-116 (15th ed. Rev. 1997) ("There is overwhelming authority to the effect that . . . subsequent dismemberment . . . should not enter into the picture.") (citing cases). Rather, contingent liabilities

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[8]COBRA obligations require employers to provide certain employees with continued health care coverage following job loss. *See* Consolidated Omnibus Budget Reconciliation Act, 29 U.S.C. §§ 1161-1168 (West Supp. 1997).

must be limited to costs arising from foreseeable events that might occur while the debtor remains a going concern. *See FDIC v. Bell* 106 F.3d 258, 264 (8th Cir. 1997). Because we treat TWA as a going concern, we will not include in the insolvency calculation the $816.4 million in liabilities associated with TWA's dissolution that was included by the bankruptcy court.

3.

The final issue we address is whether the bankruptcy court's factual finding that TWA had not reached an agreement with its creditors to reduce its public debt by $1 billion was clearly erroneous. Travellers maintains that prior to November 4, 1991, TWA had entered into a prepetition agreement with its public debt holders in which the creditors had agreed to reduce TWA's debt burden by $1 billion in exchange for certain concessions from TWA. Travellers points primarily to press releases and SEC filings authored by TWA, which indicate that TWA was attempting to restructure its debts in anticipation of reorganization under Chapter 11.

The bankruptcy court found that these efforts had not yet come to fruition as of the date of the transfer, such that the value of TWA's public debt could not be reduced by the $1 billion proposed in the debt restructuring plan. According to Travellers, the bankruptcy court clearly erred in concluding that TWA and its creditors had not reached a binding agreement, which would have reduced the face value of TWA's debt (and thus TWA's liability) by $1 billion.

On review of the record, we hold that the bankruptcy court's finding was not clearly erroneous. Although the record is clear that TWA and its creditors had entered into negotiations, there is little support for the view that

the agreement had been finalized as of November 4, 1991. All of the documents relied upon by Travellers that are dated prior to November 4, 1991 are either marked as drafts, or else indicate that the terms of the proposed agreement had not been finalized. Further, only certain elements of the alleged agreement were finalized in the plan that was ultimately approved on August 11, 1993. Accordingly, we cannot conclude that the bankruptcy court's finding that no agreement existed as of the date of the transfer was clearly erroneous. *See Haines v. Liggett Group, Inc.*, 975 F.2d 81, 92 (3d Cir. 1992) ("[T]he appellate court must accept the factual determination of the fact finder unless that determination either (1) is completely devoid of minimum evidentiary support displaying some hue of credibility, or (2) bears no rational relationship to the supportive evidentiary data.") (quotations omitted).

IV.

The holding of the bankruptcy court in this case was that TWA was insolvent on November 4, 1991 because the value of TWA's liabilities exceeded that of its assets. According to the bankruptcy court, TWA's liabilities totaled $5,124,947,000, which exceeded its asset valuation of $3,125,811,000 by two billion dollars. On review of the legal and factual issues in this case, we have concluded that the bankruptcy court's calculations were correct except insofar as the bankruptcy court included $816.4 million in liabilities associated with TWA's dissolution. Subtracting this sum from the bankruptcy court's liability figure, we conclude that the proper valuation of TWA's liabilities on the date of the transfer was $4,308,547,000. Because this figure still exceeds the $3,125,811,000 valuation of TWA's assets, we conclude that the bankruptcy court was correct in holding that TWA was

insolvent as of November 4, 1991, and that the deposit of $13.7 million on that date to stay the enforcement of the judgment against TWA in favor of Travellers was a voidable preferential transfer pursuant to 11 U.S.C. § 547(b).

Accordingly, we will reverse the district court's order dated December 30, 1996, which had reversed the insolvency holding of the bankruptcy court, and we will direct the district court to remand this case to the bankruptcy court for further proceedings consistent with this opinion.

A True Copy:
Teste:

*Clerk of the United States Court of Appeals*
*for the Third Circuit*

## APPENDIX B

*AMENDED*

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 97-7037 and 97-7082

IN RE: TRANS WORLD AIRLINES,
INCORPORATED,

*Debtor*

TRAVELLERS INTERNATIONAL AG,
*Appellant/Cross-Appellee*
*in Appeal No. 97-7037*

v.

TRANS WORLD AIRLINES, INCORPORATED;
OFFICIAL COMMITTEE OF
UNSECURED CREDITORS
FOR TRANS WORLD AIRLINES

Trans World Airlines, Incorporated
*Appellant/Cross Appellee*
*in Appeal No. 97-7082*

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On Appeal from the United States District Court
for the District of Delaware
(D.C. No. 95-cv-00031)

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Argued Friday, September 12, 1997

Present: MANSMANN, NYGAARD, and GARTH, *Circuit Judges*

JUDGMENT

These causes came to be heard on the record from the United States District Court for the District of Delaware and were argued by counsel on September 12, 1997.

On consideration whereof, it is now here order and adjudged by this Court that the judgment of the said District Court entered January 2, 1997, be, and the same is hereby reversed and the causes are remanded to the District Court with direction to remand the matter to the Bankruptcy Court for further proceedings consistent with the opinion of this Court. Cost taxed in favor of appellant/cross-appellee in appeal No. 97-7082. All of the above in accordance with the opinion of this Court.

ATTEST:

/s/ Patricia S. Colman
Acting Clerk

Dated: March 31, 1998

RECEIVED AND FILED
3/31/98
P. DOUGLAS SISK

## APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Civil Action No. 95-31-JJF

IN RE:
TRANS WORLD AIRLINES, INC.

Debtor.

TRAVELLERS INTERNATIONAL AG,

Appellant,

v.

TRANS WORLD AIRLINES, INC.,

Appellee.

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Laurie S. Silverstein, of POTTER, ANDERSON & CORROON, Wilmington, Delaware. Michael Joseph, E. Alex Blanton, Richard A. Kirby, Joseph O. Click, of DYER, ELLIS, JOSEPH & MILLS, Washington, D.C. Attorneys for Appellant.

William H. Sudell, Jr., Kenneth J. Nachbar, of MORRIS, NICHOLS, ARSHT & TUNNELL, Wilmington, Delware. David S. Kurtz, Michael J. Templeton, of JONES, DAY, REAVIS & POGUE, New York, New York. Attorneys for Appellee.

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## OPINION

December 30, 1996

Wilmington, Delware

/s/ Joseph J. Farman, Jr.
Farman, District Judge.

This is an appeal by Travellers International AG ("Travellers"), from the Bankruptcy Court's decision in favor of the debtor, Trans World Airlines ("TWA"), that TWA's $13.7 million deposit with the Clerk of the United States District Court for the Southern District of New York, intended as security for TWA's payment of a judgment rendered against TWA and in favor of Travellers in that court, was avoidable as a preference pursuant to 11 U.S.C. § 547(b). The issue raised by this appeal is whether the Bankruptcy Court applied the correct legal standard to the determination of TWA's insolvency required by 11 U.S.C. § 547(b)(3). For the reasons discussed, the decision of the Bankruptcy Court will be affirmed in part and reversed in part, and the case remanded to the Bankruptcy Court.

## BACKGROUND

### I. Statement of Facts

On October 22, 1991, the United States District Court for the Southern District of New York entered a judgment in the amount of $12.3 million against TWA and in favor of Travellers. On November 4, 1991, TWA obtained a stay of enforcement of the judgment by depositing $13.7 million in cash with the Clerk of the District Court, in lieu of a supersedeas bond. Eighty-eight days later, on January 31, 1992, TWA filed a petition for

reorganization under Chapter 11 of the Bankruptcy Code.

Following the filing of the reorganization petition, TWA commenced an adversary proceeding against Travellers to avoid and recover the cash deposit as a preference pursuant to 11 U.S.C. § 547(b) and 550. In addition, the Official Unsecured Creditors' Committee ("Creditors' Committee") in TWA's Chapter 11 case filed a separate complaint against Travellers to intervene as a party-plaintiff and seek recovery of the cash deposit for TWA as a preference.

The Bankruptcy Court conducted a trial in the TWA-Travellers adversary proceeding February 14 through 17, 1994. On November 30, 1994, the Bankruptcy Court issued its decision, holding that because the cash deposit was made within the 90 day preference period, and because TWA was insolvent at the time of the payment to the Court Clerk, the cash deposit was avoidable as a preference under Section 547(b). At issue in this appeal is the Bankruptcy Court's decision regarding TWA's insolvency on the date of the transfer.

II. The Bankruptcy Court's Decision

In determining whether the cash deposit with the Clerk of the Court was a preference, the Bankruptcy Court applied the five criteria enumerated in Section 547(b).[1]

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[1] Section 547(b) states:

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made

(3) made while the debtor was insolvent

[footnote continued]

*Trans World Airlines, Inc. v. Travellers International AG*, 180 B.R. 389 (Bankr. D. Del. 1994). In dispute in this appeal, is the third requirement, that the debtor be insolvent on the date of the transfer. 11 U.S.C. § 547(b)(3). Section 101(32) defines insolvency of a corporate debtor as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." In applying this standard, the Bankruptcy Court examined the assets and liabilities of TWA at the time the payment was made in order to determine if TWA was insolvent when the cash deposit was made.

A. *Asset Valuation*

In discussing its valuation of TWA's assets, the Bankruptcy Court undertook an in depth analysis of the meaning of the term "fair valuation" in the context of a Section 547(b)(3) insolvency determination. *Id.* at 403. The meaning ascribed to the term "fair valuation" is crucial, in that it guides the interpretation of a debtor's financial data, which then enables a court to determine if the debtor's liabilities exceed its assets, that is, whether the debtor is insolvent.

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(4) made–

(A) on or within 90 days before the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if–

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made

(C) such creditor received payment of such debt to the extent provided by the provision of this title.

After reviewing the parties' arguments and applicable case law, the Bankruptcy Court made several legal rulings with respect to the term "fair valuation." First, the Bankruptcy Court concluded that a valuation of assets requires a determination as to the amount of cash that could be realized from the sale of assets within a reasonable time. Second, the Bankruptcy Court concluded that in this context, TWA's approximation of a 12 to 18 month time period for a sale of assets constituted a reasonable time. Third, the Bankruptcy Court concluded that its definition of fair valuation was consistent with a "going concern" valuation, and was not a foreclosure or forced sale situation.

After arriving at the above legal conclusions, the Bankruptcy Court applied them to a review of TWA's position in the airline industry in 1991 and to an asset-by-asset review of the data supplied by TWA and Travellers. Rejecting Travellers arguments that TWA was merely having a liquidity problem, the Bankruptcy Court found that absent a major financial restructuring, TWA was facing bankruptcy. *Id.* at 412-415. In addition, the Bankruptcy Court rejected Travellers methodology for asset valuation, finding it deficient in many ways and inconsistent with the court's definition of "fair valuation." Therefore, with the exception of areas in which TWA offered no evidence, the Bankruptcy Court ultimately adopted a majority of TWA's valuation figures. *Id.* at 415-421. As a final figure, the Bankruptcy Court concluded that the fair value of TWA's assets was $3,125,811,000. *Id.* at 421.

B. *Debts*

In the context of its insolvency determination, the Bankruptcy Court construed the term "debt" within the meaning ascribed to it under Section 101(12). *Id.* at 422.

Under this section, "debt" is defined as "liability on a claim." 11 U.S.C. § 101(12). In determining the amount of TWA's liabilities at the relevant time period, the Bankruptcy Court examined four categories of debt: (1) debt obligations, (2) aircraft lease obligations, (3) medical and dental benefits obligations and (4) contingent liabilities. With respect to each of these categories, the Bankruptcy Court made a number of specific holdings and findings that are relevant to this appeal.

As to the debt obligation category, the Bankruptcy Court held that Travellers' position that "liabilities be determined at their fair value" was inconsistent with the plain wording of Section 101(32) and unsupported by case law and logic. *Trans World Airlines*, 180 B.R. at 423. Specifically, with regard to TWA's public debt, the Bankruptcy Court concluded that the debt holders "bargained with the debtor to recover the face amount of their claim and [that]. . . is what Section 101(32) contemplates." *Id.* at 423. The Bankruptcy Court dismissed Travellers' argument that TWA reached an agreement with groups of public note holders to eliminate $1 billion of debt, finding no factual support for such an agreement. Based upon its interpretation of the term "debt," the Bankruptcy Court found that TWA's debt obligations on November 4, 1991, were $1,776,752,000.

Regarding the categories of aircraft lease obligations and pension plan obligations, the Bankruptcy Court accepted TWA's expert reports. Travellers' calculations were dismissed because of perceived deficiencies in their expert reports.

As to medical and dental benefits obligations, which the parties agreed amounted to a $400 million liability, the Bankruptcy Court rejected Travellers' argument that this was offset by a corresponding $400 million asset.

In rejecting this position, the Bankruptcy Court asked whether having this liability was of any value to TWA. Declaring that this liability was not a saleable asset and had no market value, the Bankruptcy Court concluded that "[g]iven the orderly sale of assets scenario which I find applicable to this case, I conclude that having the liability has no value to TWA which can be considered an asset in the determination of TWA's insolvency." *Id.* at 427.

Regarding the category of contingent liabilities, the Bankruptcy Court adopted the position that contingent liabilities should be included in determining the sum of TWA's debts under Section 101(32), and that the amount of the contingent liability to be taken into account as debt is determined by the probability that the contingency will occur. In this case, the contingency the Bankruptcy Court evaluated was the cessation of TWA's operations and the termination of its business. The Bankruptcy Court rejected Travellers' contention that including such contingent liabilities was contrary to the going concern valuation required by Section 101(32) and concluded that under the orderly sale of assets approach, "[i]f TWA were required to wind down its operations and convert non-cash assets to cash in a 12 to 18 month period, its operations would obviously terminate and the liabilities contingent on that event would then become fixed." *Id.* at 427. In addition, the Bankruptcy Court rejected Travellers' assertion that TWA's SEC reports and press-releases were at odds with the conclusion that TWA's operations would cease. The Bankruptcy Court concluded that the SEC filings did not conflict with the testimony supporting inclusion of contingent liabilities and dismissed the press-releases as a "normal part of public relations." *Id.* at 428.

After reviewing tax liabilities and other liabilities that are not particularly relevant to this appeal, the Bankruptcy Court concluded that on November 4, 1991, the total of TWA's debts was $5,124,947,000. Comparing this debt figure to the previously ascertained asset value figure of $3,125,811,000 the Court determined that TWA was insolvent on November 4, 1991.

## DISCUSSION

### I. Jurisdiction and Standard of Review

Under 28 U.S.C. § 158(a), this Court has jurisdiction to hear appeals from final judgments, orders and decrees of bankruptcy judges. In reviewing a case on appeal, the bankruptcy court's factual determinations are subject to deference and shall not be set aside unless clearly erroneous. *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 641 (3d Cir. 1991), *cert. denied.*, 112 S. Ct. 1476 (1992), *Brown v. Pennsylvania State Employees Credit Union*, 851 F.2d 81, 84 (3d Cir. 1988). However, a bankruptcy court's conclusions of law are subject to plenary review. *Metro Communications*, 945 F.2d at 641. Mixed questions of law and fact are subject to a "mixed standard of review" under which the appellate court accepts finding of "historical or narrative facts unless clearly erroneous, but exercise[s] plenary review of the trial court's choice and interpretation of legal precepts and its application of those precepts to the historical facts." *Id.* at 641-42 (citing *Universal Mineral, Inc. v. C.A. Hughes & Co.*, 669 F.2d 98, 101-02 (3d Cir. 1981)). While a determination of insolvency under Section 547 is treated as a factual finding, the standard to be employed in making the insolvency finding involves legal interpretation. *See Sierra Steel, Inc. v. Totten Tubes Inc. (In re Sierra Steel, Inc.)*, 96 B.R. 275, 276-77 (9th Cir. 1989).

Therefore, the Court concludes that the insolvency issue raised in this case is a mixed question of law and fact, in which the Court's review of the legal standard applied by the Bankruptcy Court to determine insolvency is plenary.

II. Insolvency Under Section 547

In this appeal, Travellers challenges the Bankruptcy Court's ultimate conclusion that TWA was insolvent on the transfer date of November 4, 1991, as well as the holdings and findings of the Bankruptcy Court which led to this conclusion. The Court will divide Travellers' arguments into two categories, those pertaining to asset valuation and those applying to debt valuation. The Court will address each of Travellers' contentions in these areas.

A. *Asset Valuation*

Regarding the asset valuation, Travellers argues that the Bankruptcy Court misconstrued the term "fair valuation" and committed legal error by employing an "orderly sale of assets to pay creditors" approach to the valuation determination. Travellers argues that TWA's inability to pay existing and potential liabilities by converting its assets to cash within 12 to 18 months is legal error for three reasons: (1) by utilizing an asset value obtained in a sale 12 to 18 months *after* the date of transfer, this test directly conflicts with the statutory mandate requiring a determination of the debtor's financial condition *on the transfer date*, (2) the application of this test leads to such arbitrary determinations as finding that 12 to 18 months constitutes a reasonable time, and (3) the application of this test results in a forced sale or liquidation approach, which conflicts with the requirements of prevailing authorities that assets be valued on a going concern basis and ascribed their fair market value.

In response, TWA argues that the Bankruptcy Court's approach to asset valuation, which requires a determination of the funds which could be generated by converting non-cash assets into cash within a reasonable time, is properly supported by case law and the policy underlying preference questions, specifically, ensuring equality of distribution among creditors.

Generally, in conducting asset valuation for insolvency determinations, the fair market value of assets is to be used, rather than a forced sale value. *See In re Taxman*, 905 F.2d 166, 169 (7th Cir. 1990); *Edward R. Bacon Company v. Grover*, 420 F.2d 678, 678 (9th Cir. 1870); *Roemelmeyer v. Walter E. Heller & Company (In the Matter of Lackow Brothers, Inc.)*, 752 F.2d 1529 (1985); Daniel R. Cowans *Bankruptcy Law and Practice* 294 (6th ed. 1994). Forced sale or liquidation values only apply where the debtor is "wholly inoperative, defunct, or dead on its feet."

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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Civil Action No. 95-31-JJF

IN RE:
TRANS WORLD AIRLINES, INC.

Debtor.

TRAVELLERS INTERNATIONAL AG,

Appellant,

v.

TRANS WORLD AIRLINES, INC.,

Appellee.

**ORDER**

At Wilmington this 30 day of December 1996, for the reasons set forth in the Opinion issued this date;

IT IS HEREBY ORDERED that:

1) The decision of the Bankruptcy Court, *Trans World Airlines, Inc. v. Travellers International AG,* 180 B.R. 389 (Bankr. D. Del. 1994), is AFFIRMED IN PART and REVERSED IN PART; and

2) The case is remanded to the Bankruptcy Court for further consideration consistent with this Opinion.

/s/ Joseph J. Farman, Jr.
UNITED STATES DISTRICT JUDGE

## APPENDIX D

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

Case No. 92-115

In Re

TRANS WORLD AIRLINES, INC.,

Debtor.

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Adversary Proceeding No. A-92-28

TRANS WORLD AIRLINES, INC.,

Plaintiff,

and

OFFICIAL UNSECURED
CREDITORS' COMMITTEE,

Plaintiff-Intervenor,

v.

TRAVELLERS INTERNATIONAL AG.,

Defendant.

### OPINION

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November 30, 1994

/s/ Peter J. Walsh
WALSH, J.

## INTRODUCTION

TWA filed its Chapter 11 petition on January 31, 1992. TWA served as debtor-in-possession during the entire case, and its second amended plan of reorganization (the "Plan") was confirmed on August 11, 1993, effective on November 3, 1993. TWA commenced this adversary proceeding on March 10, 1992 (the "Adversary Proceeding"). On June 23, 1992, the Court authorized the Official Unsecured Creditors Committee to intervene as a party plaintiff. This is the court opinion following trial of the Adversary Proceeding.

Prior to TWA's Chapter 11 case, Travellers had filed a breach of contract action against TWA. Following a trial in the United States District Court for the Southern District of New York (the "District Court"), judgment was entered on October 22, 1991 against TWA and in favor of Travellers in the amount of $12,318,242 plus interest. On October 31, 1991, TWA and Travellers entered into a Stipulation and Order on Consent (the "Stipulation"). In summary, the Stipulation (a) continued the Fed. R. Civ. P. 62(a) stay of execution of judgment until November 4, 1991, (b) provided that by November 4, 1991, TWA could either post a supersedeas bond in the amount of $13,693,-101,[1] or deposit that amount of cash with the clerk of the District Court, which bond or cash would serve as security for TWA's payment of the judgment and interest, and (c) Travellers agreed that, upon the posting of the bond or

[1] As explained below, the difference between the $12,318,-242 judgment and $13,693,101 set forth in the Stipulation reflects (a) a recalculation of the judgment amount and (b) an 11% interest factor as called for by the local rules of the District Court for the Southern District of New York.

cash, execution upon the judgment would be stayed during the pendency of TWA's appeal. On November 4, 1991, TWA deposited cash in the amount of $13,693,101 with the clerk of the District Court. TWA filed a notice of appeal on November 19, 1991. The appeal is still pending. With the filing of TWA's Chapter 11 petition on January 31, 1992, the prosecution of the appeal was stayed by 11 U.S.C. § 362(a)[2] and Travellers has not requested relief from the stay to permit the appeal to proceed.

By the Adversary Proceeding, pursuant to §§ 547 and 550, TWA seeks to avoid and recover the cash deposit as a preferential transfer made to Travellers.[3] Since TWA

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[2]Hereinafter all citations to 11 U.S.C. § ___ are referred to as "§ ___".

[3]Section 547(b) provides:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property–
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> (1) to or for the benefit of a creditor;
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> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
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> (3) made while the debtor was insolvent;
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> (4) made–
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> (A) on or within 90 days before the date of the filing of the petition; or
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> (B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
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> (5) that enables such creditor to receive more than such creditor would receive if–
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> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b), (West 1993).

[footnote continued]

filed its Chapter 11 petition on January 31, 1992, the 90 day preference period reaches back to include transactions which occurred on and after November 2, 1991. In the alternative, pursuant to § 542(a), TWA seeks to obtain turnover of the funds alleged to belong to the estate.[4]

Of the five elements needed to establish a § 547(b) preference, Travellers argues that two are lacking here. According to Travellers, (a) the transfer occurred before November 2, 1991 and (b) TWA was not insolvent when the transfer occurred on October 31, 1991. Alternatively, Travellers argues that it is entitled to an equitable lien which overrides the avoidance power of the trustee under § 547(b). In addition, Travellers relies upon the § 547(c)(1) contemporaneous exchange for new value exception. In Part I of this opinion, following a statement

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Section 550(a) provides:

> Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—
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> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
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> (2) any immediate or mediate transferee of such initial transferee.

11 U.S.C. § 550(a) (West 1993).

[4] Section 542(a) provides:

> Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C. § 542(a) (West 1993).

of the facts relating to the Stipulation, I address the issues of (a) when the transfer occurred, (b) whether an equitable lien exists and (c) whether there was a contemporaneous exchange for new value. The insolvency issue will then be separately addressed in Part II.

Because I find that the transfer occurred on November 4, 1991, and that TWA was insolvent on that date, the transfer is avoidable as a preference pursuant to § 547(b). Furthermore, because I find that Travellers does not hold an equitable lien on the deposited cash and that the deposited cash was not a contemporaneous exchange for new value, the transfer is not excepted from the provisions of § 547(b) and § 550.[5]

## PART I

## FACTS REGARDING STIPULATION

Following the District Court's entry of judgment against TWA on October 22, 1991, trial counsel for TWA and trial counsel for Travellers commenced extensive oral and written communications which culminated in the entry of the Stipulation on October 31, 1991. These communications essentially concerned (1) a correction to the amount of the judgment, (2) disagreement as to the expiration of the 10 day automatic stay of execution provided by Fed. R. Civ. P. 62(a)[6] and (3) the protection of

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[5] Because I find that the cash deposit is recoverable by TWA as a preferential transfer, I do not address TWA's alternative § 542(a) turnover request.

[6] In pertinent part, Fed. R. Civ. P. 62(a) provides:

> Except as stated herein, no execution shall issue upon a judgment nor shall proceedings be taken for its enforcement until the expiration of 10 days after its entry.

Fed. R. Civ. P. 62(a).

Travellers' interest pending an anticipated appeal by TWA.

Both counsel recognized the need to recalculate the October 22, 1991 judgment amount to reflect the proper interest rate. Travellers' counsel performed a recalculation of the judgment amount from $12,318,242 to $12,336,127.41 and communicated it to TWA's counsel who confirmed its correctness. Because of counsels' differing views of the application of Fed. R. Civ. P. 62(a), they disagreed as to when the 10-day automatic stay period expired – with TWA asserting November 6, 1991 and Travellers asserting November 1, 1991. Counsel compromised by agreeing that the 10-day stay remained in effect until 11:59 p.m. on November 4, 1991.

The third issue – Travellers' execution rights and protection pending an anticipated TWA appeal – dominated counsels' communications leading up to the Stipulation. Pursuant to Fed. R. Civ. P. 62(d), TWA could simply post a supersedeas bond with the clerk of the District Court to obtain a stay pending appeal. However, TWA wanted the right to make a cash deposit with the clerk rather than post a bond. Making a cash deposit rather than posting a bond requires a court order, but such orders are routinely granted on request.

On October 25, 1991, TWA's counsel faxed to Travellers' counsel a discussion draft of a stipulation addressing the three issues. As to Travellers' protection, that draft provided as follows:

> 2. On or before 5:00 p.m. on November 4, 1991, Defendant Trans World Airlines, Inc. ("TWA") if it does not provided [sic] a supersedeas bond, *shall* deposit the sum of $13,673,249.64, by wire transfer or by cash or certified check, with the Clerk of this Court in lieu of a supersedeas bond, said sum reflect-

> ing the total amount of the judgment in favor of Plaintiffs and an additional 11% of said judgment as additional security; [emphasis added].

Travellers' counsel made extensive revisions to the draft and faxed it back to TWA's counsel on October 29, 1991. According to Travellers' counsel, for grammatical purity, he changed the word "shall" to "may" in the above quoted paragraph 2. In addition, among other changes, Travellers' counsel added a paragraph 6 which read as follows:

> 6. If TWA provides the Cash Deposit to the Clerk of the Court for deposit in the CRIS account, in order to secure payment of the judgment, post-judgment interest and costs, *TWA hereby grants a security interest to Travellers in the Cash Deposit* in the total amount of the judgment, post-judgment interest and costs. [emphasis added].

The proposed paragraph 6 specifically purported to grant a security interest to Travellers. TWA's counsel rejected this paragraph and it was deleted from the final version of the Stipulation.

During the communications leading to the Stipulation, a further issue regarding the stay provision arose. Travellers' counsel was concerned that a failure on his part to record the judgment with the clerk of court in New York County and elsewhere might constitute professional malpractice. He expressed the view to TWA's counsel that such a recording would not violate the stay of Fed. R. Civ. P. 62. In his October 29, 1991 return draft, Travellers' counsel included a provision directed to this issue which read as follows:

> 7. Upon payment of applicable fees, if any, the Clerk of the Court is directed on or after the date of

> this Stipulation and Order (i) to provide a transcript of the judgment to counsel for Travellers so that Travellers can record the judgment in counties in New York and (ii) to certify the judgment for registration in other districts and to take any other action necessary to allow Travellers to register the judgment in other districts pursuant to 28 U.S.C. § 1963, good cause for such registration having been shown, so that Travellers can take the necessary steps to record the judgment in districts other than New York.

TWA's counsel objected to this provision, asserting that a recordation would constitute an act in enforcement of the judgment within the contemplation of Fed. R. Civ. P. 62. The parties resolved this issue by deleting the above quoted paragraph 7 but, at the request of Travellers' counsel, advising the District Court judge in the letter transmitting the final form of the Stipulation that this was an open issue between the parties and it might be presented to the judge for resolution at a later time.

Travellers' counsel advised TWA's counsel that he wished to obtain from the District Court clerk a transcript of the judgment so he could record it in the New York County clerk's office as well as other places. Travellers' counsel hoped to obtain a lien on TWA property by recording the judgment. He cited to TWA's counsel a number of cases which he believed supported Travellers' position that such recording was not a step in the enforcement of the judgment. TWA's counsel took a contrary view, asserting that any such recordation would constitute a step in the enforcement of the judgment. He advised Travellers' counsel that if Travellers' counsel took steps to record the judgment, TWA would move to have him held in contempt for violation of the stay.

Sometime during the course of this debate, Travellers' counsel communicated with the Clerk of the District Court. The clerk advised that it was his interpretation of Fed. R. Civ. P. 62(a) that giving TWA a transcript of the judgment would be a step in enforcement of the judgment and therefore such a transcript would be given only if the District Court judge ordered it to be given.

According to Travellers' counsel, the parties reached what he characterized as a "day to day agreement" that Travellers would forbear from going to the judge to seek such an order. He testified that Travellers' forbearance was based on the continuing debate on the recordation issue and on his belief that the issue would be mooted by what he perceived as a "promise" by TWA to post cash to obtain a stay. TWA's counsel denied that there was any forbearance agreement or promise by TWA. According to him, the only agreement by Travellers was that it would not seek such an order from the judge without appropriate notice to TWA's counsel. In any event, viewing the testimony in Travellers' favor, it is to the effect that (a) the "agreement" was not to forbear from recording the judgment, but to forbear from seeking an order from the judge allowing such recording, and (b) the forbearance was not in exchange for a commitment by TWA in the Stipulation to post cash because the "day to day agreement" was in effect before the parties signed the Stipulation.

Counsel signed the Stipulation on October 30, 1991, and TWA's counsel delivered it with a transmittal letter to the District Court judge, who signed it on Thursday, October 31, 1991. In its entirety, the Stipulation is as follows:

> WHEREAS, a judgment for plaintiff Travellers International AG ("Travellers") in this action in the

sum of $12,318,242.92 was entered on this Court's docket on October 22, 1991; and

WHEREAS, the parties agree that the proper calculation of pre-judgment interest until the judgment was entered results in a total sum of $12,336,127.41 and that the judgment should be amended to state that amount and entered *nunc pro tunc* as of October 22, 1991; and

WHEREAS, the parties wish to establish and agree upon their respective rights and obligations with respect to the judgment, execution thereon and stays thereof, and the time for defendant Trans World Airlines, Inc. ("TWA") to file a bond or other security pending appeal;

IT IS HEREBY STIPULATED AND AGREED THAT:

1. The proper calculation of the judgment is $12,336,127.41. The Clerk of the Court is directed to enter judgment for that amount, attached here as Exhibit A, *nunc pro tunc*, as of October 22, 1991.

2. The automatic stay of proceedings to enforce a judgment provided by Fed. R. Civ. P. 62(a) shall remain in effect until 11:59 p.m. on Nov. 4, 1991.

3. On or before 5:00 p.m. on November 4, 1991, defendant, if it does not provide a supersedeas bond in the amount of $13,693,101.42, may deposit the sum of $13,693,101.42 (the "Cash Deposit"), by wire transfer or by cash or certified check, with the Clerk of this Court in lieu of a supersedeas bond.

4. The sum TWA provides, whether by supersedeas bond or Cash Deposit, reflects the total amount of the judgment in favor of Travellers and an additional 11% of said judgment and is provided by TWA as security to secure payment to Travellers of the judgment, post-judgment interest and costs,

should Travellers prevail on appeal and be held entitled to same in whole or in part.

5. If TWA elects to provide the Cash Deposit as set forth in paragraph 3 above, the Clerk of the Court is directed to deposit the Cash Deposit in the interest-bearing Court Registry Investment System ("CRIS") account, and all interest accruing on the Cash Deposit shall be paid to TWA on a quarterly basis.

6. Upon receipt by the Clerk of the Court of the aforementioned supersedeas bond or Cash Deposit from TWA, Travellers is stayed from executing on all or any part of the judgment entered in this action pending the hearing and determination of TWA's appeal. If the time for TWA to take an appeal from the judgment entered in this action expires without TWA having done so, the stay granted herein shall expire concurrently.

On Monday, November 4, 1991, TWA transferred by wire a cash deposit of $13,693,101 to the clerk of the District Court.

TWA claims that it is the November 4, 1991 wire transfer of $13,693,101 which constitutes the § 547(b)(4)(A) transfer. Travellers claims that the transfer took place on October 31, 1991 when the parties entered into the Stipulation. Travellers' position rests on the argument that the Stipulation was a security agreement as contemplated by N.Y.U.C.C. § 9-105(1) (McKinney 1992 Supp.) which took effect October 31, 1991 and which, pursuant to N.Y.U.C.C. § 9-304(1) and § 9-305, became perfected by the wire transfer of funds on November 4, 1991. Alternatively, Travellers argues that (a) it has an equitable lien on the deposited funds, or (b) the deposited funds were in exchange for new value.

## DISCUSSION

*The Stipulation as a Security Agreement*

Briefly stated, Travellers' argument is as follows:

1. The central focus is on paragraph 4 of the Stipulation. It states that "[t]he sum TWA provides, whether by supersedeas bond or Cash Deposit, . . . is provided by TWA as security to secure payment to Travellers of the judgment. . . ." This language is consistent with that of the U.C.C. which defines the term "security interest" as "an interest in personal property . . . which secures payment . . . of an obligation" N.Y.U.C.C. § 1-201(37) (McKinney 1992 Supp.). Thus, according to Travellers, the Stipulation is a security agreement because it is an agreement "which creates or provides for a security interest." *Id.* § 9-105(1)(c).

2. A security interest attaches when (1) the debtor has signed a security agreement describing the collateral, (2) value has been given; and (3) the debtor has rights in the collateral. N.Y.U.C.C. 9-203(1)(a)(b)(c) (McKinney 1992 Supp.) According to Travellers: (1) TWA signed the Stipulation/security agreement which described collateral as the cash that TWA would deposit with the clerk; (2) Travellers gave value to TWA in the form of (a) a stay of execution, (b) the option of depositing cash in lieu of posting a bond, (c) the right to collect interest on the funds deposited, and (d) the right to obtain a stay of execution pending appeal before filing its notice of appeal, thereby giving TWA an additional 20 days within which it could file a notice of appeal without subjecting itself to execution of the judgment, and (3) TWA had rights in the collateral because it had sufficient cash (in excess of $377,000,000) to make a cash deposit of $13,693,101.42 at the time it signed the Stipulation. Travel-

lers therefore argues that its security interest attached on October 30 when the parties signed the Stipulation.

3. Section 547(e)(2)(A)[7] provides that "a transfer is made . . . at the time such transfer takes effect between the transferor and transferee, if such transfer is perfected at, or within 10 days after, such time." A security interest in money can be perfected by a third party, such as the clerk, taking possession of the money. N.Y.U.C.C. §§ 9-304(1) and 9-305 (McKinney 1992). Travellers argues that its security interest provided by the Stipulation was perfected when TWA deposited funds with the clerk.

For the reasons set forth below, I find that the Stipulation lacks essential elements needed to effect an attachment of a security interest.

There is no security agreement unless the parties so intend. 2 *White & Somers Uniform Commercial Code* § 24-3 (3d ed. 1988).[8] A number of provisions and terms

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[7] Section 547(e)(2)(A) provides:

> (2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—
>
> (A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time;

11 U.S.C. § 547(e)(2)(A) (West 1993).

[8] *White & Somers* suggest that in making a determination of the existence of a security agreement two separate inquiries are involved, first, a question of law as to whether the language embodied in the writing objectively indicates an intent to provide for a security interest, and second, a question of fact as to whether the parties actually intended a security agreement. In problem cases, parol evidence is admissible as to the second inquiry, but not the first. 2 *White & Somers Uniform Commercial Code* § 24-3 (3d ed. 1988). Over TWA's objection I permitted parol evidence on this issue. Ironically, that evidence supports TWA's position. For the reasons set forth herein, I find for TWA on both the legal and the factual inquiry.

of the stipulation cause me to conclude that the parties did not so intend.

1. The Stipulation does not state that TWA "is hereby granting a security interest" or that TWA "shall" make a deposit of cash with the clerk. On the contrary, it provides that if TWA does not provide a supersedeas bond it *may* make a cash deposit.

2. The third "whereas" clause of the Stipulation recites that one of the purposes of the Stipulation is to "establish and agree upon . . . the *time* for [TWA] to file a bond or other security pending appeal." (emphasis added) That recited purpose is inconsistent with Travellers' claim that the "security" was given upon execution of the Stipulation, since the Stipulation expressly establishes the "time" as November 4, 1991.

3. Paragraph 4 of the Stipulation is entirely consistent with the security arrangement contemplated by Fed. R. Civ. P. 62. The bond or cash deposit was to be security for Travellers' judgment "should Travellers prevail on appeal and be held entitled to same in whole or in part." If TWA elected not to appeal, there was obviously no reason why it would elect to provide security to extend the stay provided by Rule 62.

4. Paragraph 6 of the Stipulation provides that upon receipt by the clerk of the bond or the deposit of cash, Travellers is stayed from executing on the judgment pending appeal. The converse of this is implicit: if no bond is posted or no deposit of cash is made, then there would be no stay of Travellers' right to execute on the judgment. Except for the Cash Deposit alternative to a bond, this is exactly what is contemplated by Fed. R. Civ. P. 62, because the judgment holders' benefit from Rule 62 is triggered upon the furnishing of security to the clerk.

5. Absent possession of the collateral by the secured party, a security interest is not enforceable against the debtor . . . unless . . . the debtor has signed a security agreement which contains a description of the collateral." N.Y.U.C.C. § 9-203(1)(a) (McKinney 1990). The Stipulation does not contain a description of existing collateral. It merely specifies two possible methods whereby collateral would be created if TWA elected to have a stay pending appeal – by (a) TWA depositing cash with the clerk, or (b) TWA providing a bond to the clerk. Travellers' argument that the collateral existed on October 31, 1991 because on that date TWA had cash of in excess of $377,000,000 is unavailing. The Stipulation does not say that the "security" is the sum of $13,693,101 which at that time was a part of TWA's cash holdings. Nor does the Stipulation specify a bank account or other source from which TWA would create the Cash Deposit, or grant Travellers' rights in such source. By definition "Cash Deposit" did not exist until the deposit occurred on November 4, 1991.

6. Paragraph 5 of the Stipulation provides that the clerk is required to put the Cash Deposit in an interest bearing account "[*i*]*f* TWA *elects* to provide the Cash Deposit as set forth in paragraph 3 above, . . . ." [Emphasis added.] If TWA had instead elected to post a bond as collateral, the bond/collateral was not in existence on October 31, 1991.[9] Therefore, TWA had no rights in the

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[9]Travellers ignores the existence of TWA's posting a bond as an alternative to depositing cash. For example, it argues that "[i] t is beyond cavil that paragraph 4, which states that 'the sum TWA provides . . . is provided by TWA as security . . . ,' created a security interest for the benefit of Travellers in the money that TWA would later deposit with the clerk." Def. Br. 3. Travellers quotation from paragraph 4, omits the words "whether by supersedeas bond or Cash Deposit" following the phrase "the sum TWA provides."

bond/collateral at that time and Travellers' interest could not attach to the bond/collateral. Section 547(e)(3) provides that a transfer is not made until the debtor has acquired rights in the property. Since TWA never purchased a bond, there was never a transfer of an interest in the bond. Since the Cash Deposit was a substitute for the bond and it did not come into existence until it was created on November 4 by TWA making a deposit of cash, a transfer did not occur until that date.

7. A security interest does not attach "until it becomes enforceable against the debtor with respect to the collateral." N.Y.U.C.C. § 9-203(2) (McKinney 1992). Prior to November 4, 1991, Travellers did not have enforcement rights against the "collateral" as the collateral did not exist. It certainly had no enforcement rights in a nonexisting bond or cash in TWA's bank account. The Stipulation contemplated that if no bond or cash deposit was posted, there would be no stay and Travellers could execute on its judgment. It would be unnecessary for Travellers to take action to execute on its judgment if it already had a lien on the "collateral." Under the circumstances, the conclusion seems inescapable that no security interest attached until TWA made the deposit with the clerk on November 4, 1991.[10]

8. "Perfection" of a security interest within the contemplation of U.C.C. § 9-303 is typically effected by an act performed by the creditor, e.g., filing a security statement. Travellers notes that "debtors frequently transfer a

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[10] While pointing out that he is not an expert in this area of the law, Travellers' counsel testified that he did not know whether the Stipulation gave collateral that TWA could foreclose on had the deposit of cash not been made on November 4, 1991. Tr. 503. He further testified that had the deposit not been made he would have recorded the judgment and sought to execute thereon. Tr. 501-02.

security interest in property, conditioned upon the subsequent perfection of that interest by the *creditor*." Def. Reply Br. 10. (emphasis added) However, the act which purports to effect perfection here is an act performed by the debtor. More importantly, it is an act which was optional on the part of the debtor. For purposes of § 547 (e)(2)(A), I conclude that "perfection" does not include an act performed by the debtor within its discretion.[11]

Within the four corners of the Stipulation document, I find no significant indicia that the parties intended a security agreement. The Stipulation does contain a slim reed of support for Travellers' position. Travellers points to the specific language of paragraph 4 that "[t]he sum TWA provides, whether by supersedeas bond or Cash Deposit, . . . is provided by TWA as security to secure payment to Travellers of the judgment . . ." Travellers focuses on the present tense of the statement and on the term "security." These two factors do little to outweigh the impact of the items discussed above. Furthermore, if one resorts to matters outside the four corners of the document, the conclusion is even more compelling that the parties did not intend a security agreement. I therefore address matters outside the four corners of the document.

By his October 29, 1991 draft of the Stipulation, Travellers' counsel specifically requested TWA's counsel to include a paragraph which recited that "TWA hereby grants a security interest to Travellers in the Cash Deposit." This request was rejected and Travellers' proposed paragraph was deleted in the next draft of the

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[11] This is consistent with § 362(b)(3) which excepts from the automatic stay acts of a *creditor* in perfecting a security interest within the 10 day period.

document.[12] If Travellers' counsel believed that the term "security" in paragraph 4 of the Stipulation was the granting of a security interest, why did he seek to add a paragraph which provided that "TWA hereby grants a security interest?" Having sought to insert language which purportedly would have achieved a desired result, it seems incongruous for Travellers to argue that the result was achieved in the absence of the proposed language.

TWA's counsel testified that the purpose of the Stipulation, in addition to resolving the Fed. R. Civ. P. 62(a) 10 day timing issue and correcting the amount of the judgment, was to simply obtain an order authorizing the clerk to accept a cash deposit in lieu of a supersedeas bond to avoid a lot of unnecessary motion practice. TWA's counsel's understanding of the Stipulation was that it did not require TWA to either post a bond or make a cash deposit unless it wanted to continue the stay of execution; he never intended or understood the Stipulation to grant Travellers a security interest. His understanding of the reference to "security" in paragraph 4 of the Stipulation was a reference to Fed. R. Civ. P. 62 which uses the terms "bond or other security". On the

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[12] TWA's counsel testified:

> I called [Travellers' counsel] to discuss my position on several provisions that were in [the October 29] draft, not just the paragraph numbered 6. With respect to number 6, I specifically and point-blank stated we would not agree to this. I told him that if TWA put up a supersedeas bond, if TWA put up – if it wanted to extend the automatic stay, if it put up cash or wire transfer in lieu of the supersedeas bond, then Travellers had whatever rights it had under the law upon putting up the bond or the cash.

Tr. 59-60.

other hand, Travellers' counsel testfied on direct examination that he believed the Stipulation was designed to "grant to Travellers a security interest that was going to be perfected by the posting of cash to follow." Tr. 478. However, he subsequently testified on cross examination that if TWA did not want a stay it was not required to either post a bond or deposit the cash.[13] In this regard, Travellers' counsel's testimony is consistent with TWA's counsel's understanding of the purpose of the Stipulation.

In the October 30, 1991 transmittal letter by TWA's counsel to the District Court judge, counsel stated that the parties were requesting that the judge approve the Stipulation "so that the parties may take the appropriate steps, including provision for security pending appeal." PX 22, p. 2. Such language speaks in terms of prospective acts, i.e., the posting of security with the clerk on or before November 4, 1991, rather than in terms of a security interest having already been granted upon the signing on October 30th or, being effective upon approval by the judge. The quoted language in the letter was

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[13] Travellers' counsel testified:

Q. The stipulation says that if TWA does not provide a supersedeas bond, they may do something else, right?

A. Yes

Q. But they're not required to do that something else, are they?

A. If they don't want a stay, they're not required to do either one of them . . .

Tr. 484.

Notwithstanding its witness' testimony, Travellers asserts that "it is . . . unarguable that TWA's execution of the agreement was a commitment by TWA to transfer that security interest," Def. Reply Br. 3.

reviewed by Travellers' counsel prior to the letter being delivered to the judge.

In summary, since TWA had the option to provide security on or before November 4, 1991, the Stipulation was not a security agreement, i.e., "an agreement which creates or provides for a security interest." It merely established a procedure whereby, if TWA so elected, it would provide security to Travellers pending the appeal. If TWA elected not to provide security, in the form of a bond or the Cash Deposit, it exposed itself to the risk of a judgment creditor's execution rights. Travellers' interest in the Cash Deposit is therefore no different than that of any other judgment creditor in cash deposited, in lieu of a bond, with a clerk to stay execution pending appeal. *See, Pan Am. World Airways, Inc. v. Care Travel Co. Ltd. (In Re Pan Am. Corp.)*, 138 B.R. 382 (Bankr. S.D.N.Y. 1992), *Aff'd in part*, 166 B.R. 538 (S.D.N.Y. 1993); *In re Thomson McKinnon Sec. Inc.*, 125 B.R. 94 (Bankr. S.D.N.Y. 1991). That interest is created by operation of Fed. R. Civ. P. 62 and for Travellers it came into existence on November 4, 1991.

The fact that Travellers expected TWA to appeal and therefore to post security, and that TWA stated that it anticipated taking an appeal and posting security, does not negate the fact that by the terms of the Stipulation and in accordance with the understanding of both counsel, TWA was not obligated to do either.

Both parties cite to the court a number of escrow account cases, Travellers to demonstrate language which creates a security interest and TWA to demonstrate that the transfer occurs upon the physical transfer of the funds. I do not find these cases helpful in resolving the issue here. TWA cites *Barnhill v. Johnson*, 503 U.S. ____,

118 L.Ed.2nd 39, 112 S.Ct. 1386 (1992). The Supreme Court's reasoning in *Barnhill*, a case arising under Article 3 of the U.C.C., is applicable here by analogy. There the Court held that the date of transfer for perfection purposes was not when the check was delivered to the creditor outside the preference period, but on the later date inside the preference period when the debtor's bank honored the check. *Barnhill* rejected the notion that an interest passed from the debtor to the creditor when the check was delivered.

> Petitioner argues that the Court of Appeals erred in ignoring the interest that passed from the debtor to the petitioner when the check was delivered on a date outside the 90-day preference period. We disagree. We begin by noting that there can be no assertion that an unconditional transfer of the debtor's interest in property had occurred before November 20. This is because, as just noted above, receipt of a check gives the recipient no right in the funds held by the bank on the drawer's account. Myriad events can intervene between delivery and presentment of the check that would result in the check being dishonored. The drawer could choose to close the account. A third party could obtain a lien against the account by garnishment or other proceedings.

*Id.* at 1390.

I similarly reject the notion that an interest transferred when the parties signed the Stipulation. Before TWA created the Cash Deposit on November 4, 1991, it could have transferred all or substantially all of its cash to another creditor or creditors, or, some other judgment or lien creditor or creditors could have seized the cash

through appropriate attachment proceedings.[14] Travellers dismisses the relevance of *Barnhill* on the grounds that a check is not like a security agreement. Of course, that position begs the question by assuming that the Stipulation is a security agreement.

Travellers argues that the § 101(58)[15] definition of "transfer" includes a "conditional" transfer and paragraph 4 of the Stipulation may fairly be read as transferring to Travellers a security interest "conditioned" on TWA posting cash by November 4. Since this condition was in fact fulfilled, Travellers argues that the transfer can be said to have occurred on October 31, 1991. The court in *Barnhill* rejected the same argument.

> [P]etitioner retreats to the definition of "transfer" contained in § 101[58]. Petitioner urges that rather than viewing the transaction as involving two distinct actions—delivery of the check, with no interest in property thereby being transferred, and honoring of the check, with an interest being transferred—that we instead should view delivery of the check as a "conditional" transfer. We acknowledge that § 101[58] adopts an expansive definition of transfer, one that includes "every mode . . . absolute or conditional . . . of disposing of or parting with property or with an interest in property." There is thus some

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[14] At the time of the Stipulation, it was a matter of public knowledge that TWA was in material default on hundreds of millions of dollars of secured and unsecured debt.

[15] Section 101(58) provides:

> "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption.

11 U.S.C. § 101(58) (West 1993).

> force in petitioner's claim that he did, in fact, gain something when he received the check. But at most, what petitioner gained was a chose in action against the debtor. Such a right, however, cannot fairly be characterized as a conditional right to "property or an interest in property," § 101[58], where the property in this case is the account maintained with the drawee bank. For as noted above, until the moment of honor the debtor retains full control over disposition of the account and the account remains subject to a variety of actions by third parties. To treat petitioner's nebulous right to bring suit as a "conditional transfer" of the property would accomplish a near-limitless expansion of the term "conditional." In the absence of any right against the bank or the account, we think the fairer description is that petitioner had received no interest in debtor's property, not that his interest was "conditional."

*Barnhill*, 113 S.Ct. at 1390-91.

Finally, the conclusion which I have recited above, that on the facts here § 547(e)(2)(A) does not create an earlier transfer date, seems entirely consistent with the conclusion of the Court in *Barnhill* as to the application of § 547(3)(2)(A) to the facts there.

> Finally, we note that our conclusion that no transfer of property occurs until the time of honor is consistent with § 547(e)(2)(A). That section provides that a transfer occurs at the time the transfer "takes effect between the transferor and the transferee. . . ." For the reasons given above, and in particular because the debtor in this case retained the ability to stop payment on the check until the very last, we do not think that the transfer of funds in this case can be said to have "taken effect between

the debtor and petitioner" until the moment of honor.

*Barnhill*, 113 S.Ct. at 1391.

*Equitable Lien*

Absent a UCC Article 9 security agreement, Travellers argues that it has an equitable lien on the deposited funds. According to Travellers, New York law permits the imposition of an equitable lien where, as here, according to Travellers, a debtor and creditor agree, expressly or by implication, that certain property will be maintained as security for the debtor's obligation to the creditor. In support of its position Travellers relies principally upon five cases. *Security Pac. Mortgage & Real Estate Serv., Inc. v. Republic of Philippines*, 962 F.2d 204, 208 (2d Cir. 1992); *In re Gebco Inv. Corp.*, 641 F.2d 143, 146 (3d Cir. 1981); *F. W. Eversley & Co. Inc. v. East N.Y. Non-Profit HDFC, Inc.*, 409 F.Supp. 791, 799 (S.D.N.Y. 1976); *G. L. Wilson Bldg. Co. v. Leatherwood*, 268 F. Supp. 609, 621 (W.D.N.C. 1967); *James v. Alberton Dock Yards, Ltd.*, 176 N.E. 401 (1931), *rearg. denied*, 256 N.Y. 681, 177 N.E. 191 (1931). I find none of the cases factually apposite. Four of the five cases involved creditors who performed construction or maintenance work on real estate owned or managed by the defendant(s). *See, Security Pacific*, 962 F.2d at 207; *Gebco*, 641 F.2d at 145; *Eversley*, 409 F.Supp. at 793; *Wilson*, 268 F.Supp. at 610. In two of the five cases equitable liens were not imposed. *See, Security Pacific*, 962 F.2d at 208-210 and *James*, 176 N.E. at 403-404. In those cases in which the courts found for the creditors on equitable theories, the court also found that the defendant(s) would be unjustly enriched because the creditors performed work with the expectation of payment. *See,*

*Gebco*, 641 F.2d at 146, 147, 148-149 (funds earmarked for benefit of subcontractor); *Eversley*, 409 F.Supp. at 795-797 (plaintiff led to expect payment and defendant's past practices induced plaintiff's participation); *Wilson*, 268 F.Supp. at 615, 621-622 (defendants promised on a number of occasions that payments would be forthcoming).

To align itself with these cases, Travellers claims that the Stipulation evidenced the parties' intention that TWA would convey funds as security for the judgment pending appeal and that Travellers relied on the funds existence to its detriment by refraining from establishing alternative security in the form of a judicial lien. Travellers articulates its equitable lien position in its post-trial brief as follows:

> Travellers refrained from obtaining a judicial lien on or before November 1 *only* because TWA represented that it would deposit the cash on November 4.[16] Thus if the stipulation had not been executed and if TWA had not assured Travellers that security would in fact be posted, Travellers would, *before the beginning of the preference period,* have *obtained a judicial lien* on property sufficient to satisfy its judgment. . . .
>
> By promising to establish a fund to provide security for the judgment, TWA induced Travellers to surrender this alternative security. Under these circumstances, the law creates an equitable lien in favor of Travellers. That equitable lien came into existence at the time of the conduct giving rise to its imposition,

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[16] Presumably, the November 1 date is Traveller's calculation of the commencement of the 90-day preference period. According to my calculation, the preference period commenced on November 2, 1991.

> *i.e.*, when TWA induced Travellers to forego creation of a judicial lien.

Def. Br. 16 (emphasis added).

Travellers' argument is not supported by facts. First, as already discussed, I conclude that TWA did not promise to post a bond or create the Cash Deposit. It merely agreed that if it wished to take an appeal and wished to have a stay of execution pending the appeal, it would post a bond or create the Cash Deposit.[17] Travellers was justified in expecting the deposit to be made by November 4, 1991. However, mere expectation of payment is insufficient to establish an equitable lien. *Security Pacific*, 962 F.2d at 208. Second, Travellers did not refrain from obtaining a judicial lien prior to the preference period because of TWA's alleged promise to make a cash deposit. It was barred from doing so by Fed. R. Civ. P. 62(a). To resolve a conflict as to how to interpret that Rule, the Stipulation specified that the Rule's automatic 10 day stay would not expire until 11:59 P.M. on November 4, 1991.

Travellers' claim that there was some type of "day to day agreement" for Travellers to forbear is an amorphous argument. Accepting Travellers' version, the testimony is that (a) the clerk of the District Court advised that he deemed the issuance of the judgment transcript as a step in the enforcement of the judgment, that such a step was barred by Fed. R. Civ. P. 62(a), and that no such transcript would be given absent a court order; (b) the for-

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[17] While claiming that Travellers' forbearance was in some fashion based on TWA's counsel's "assurance" that TWA was going to post cash, Travellers' counsel repeated that TWA's posting of security was optional: "TWA was going to post cash or a bond if they wanted a stay." Tr. 487.

bearance "agreement" was not to forbear from recording the judgment but from seeking an order from the judge allowing a recording; and (c) the forbearance was not in exchange for a commitment by TWA in the Stipulation to post cash because the forbearance agreement was in effect before the parties signed the Stipulation. Thus, even assuming there was such an agreement to forbear, it was not tied to the Stipulation.

Even if Travellers had sought such an order from the judge, there is no basis on which to conclude that it would have been granted. Absent proof that Travellers was entitled to such an order as a matter of law, I cannot conclude that Travellers was prejudiced by refraining from seeking it. Finally, Travellers offered no evidence as to what property would be liened even if the order were granted and the judgment transcript recorded with the clerk for New York County and elsewhere. The recordation could create a lien only against TWA real property, and Travellers offered no evidence as to the existence of TWA real property in such locations or to whether the lien would have sufficient priority to give value to Travellers' interest. Of course, the recordation could not create a lien on personal property, including TWA's purported cash position of $377,000,000, absent an attachment proceeding. Any such proceeding would have violated Fed. R. Civ. P. 62(a). Thus, even assuming the existence of such a forbearance agreement, I conclude that Travellers did not rely upon it to its detriment and find no basis to impose an equitable lien in favor of Travellers.

Travellers also relies upon *Sexton v. Kessler & Co.*, 172 F. 535, 543 (2d Cir. 1909), *Aff'd*, 225 U.S. 90 (1912) and *Pine Top Ins. Co. v. Century Indemn. Co.*, 123 B.R. 287 (N.D. Ill. 1990). These cases are not on point. *Sexton* was decided in 1912 and has been superseded by sub-

sequent legislation. *See* James Wm. Moore, *Collier on Bankruptcy* ¶ 60.38 at 951 (14th ed. 1977) ("the elimination of the doctrine of *Sexton v. Kessler* accomplished by the 1938 Act, has been carried forward in the 1950 Amendment"). In any event, *Sexton* held only that a creditor had an equitable lien on "specific identified stocks and bonds" which the debtor had segregated for the creditor and placed in "escrow" in a safety deposit vault. *Sexton*, 225 U.S. at 98. The Court found that those actions "purported not to promise, but to *transfer*" an "absolute *present* right" to the secutiries. *Id.* (emphasis added). Travellers had no "absolute and present right" to any particular TWA property until at least November 4, 1991. Thus, *Sexton* does not support Travellers' argument for an earlier transfer. Similarly, the decision in *Pine Top* is neither persuasive or apposite, as it relies on *Sexton*, 123 B.R. at 295-96, and involved identified collateral which all parties understood was to serve as full security for the transaction, *id.* at 289, 297.[18]

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[18] I believe there is serious doubt as to whether an equitable lien theory applied to a transaction otherwise governed by U.C.C. Article 9 is cognizable in a § 547 action. Section 60(a)(6) of the old Bankruptcy Act, 11 U.S.C. § 60(a)(6), was enacted in 1950 to avoid a resurrection of the pre-1938 (Chandler Act) cases which recognized equitable liens and in turn immunized them from the trustee's preference attack under § 60(a)(6) of the Act. *See generally, In re Washington Communications Group, Inc.*, 10 B.R. 676, 679 (Bankr. D.D.C. 1981). In *Matter of Einoder*, 55 B.R. 319, 328 (Bankr. N.D. Ill. 1985), the court reasoned that although § 60(a)(6) was not included in the Bankruptcy Reform Act of 1978 it maintained its approval through the Gilmore Committee Report on the Code, see H.R. Rep. No. 595, 95th Cong., 1st Sess. 209, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, which stated that § 60(a)(6) was no longer necessary because Article 9 of the UCC had "turned the 'equitable liens' against which § 60(a)-

[footnote continued]

*Contemporaneous Exchange for New Value*

Travellers argues that the cash deposit was a contemporaneous exchange for new value and therefore the transfer is excepted under § 547(c)(1).[19] Pursuant to § 547(g), Travellers has the burden of proof in establishing a subsection (c) exception.

According to Travellers, the cash transfer was in performance of the obligation that TWA incurred by the Stipulation, *not* on account of the underlying judgment. Focussing on the § 547(a)(2) definition of "new value," which includes a "release by a transferee of property

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(6) was directed into 'unperfected security interests' which the trustee can in any case set aside", *see* U.C.C. § 9-301(3) (1984). The Seventh Circuit has held that equitable liens are contrary to the policy of bankruptcy law. *Small v. Beverly Bank*, 936 F.2d 945, 949 (7th Cir. 1991). I note, however, that in *Lewis v. Diethorn*, 893 F.2d 648 (3d Cir.), *cert. denied*, 498 U.S. 950 (1990), where the court held that a settlement of a law suit was not a preference transaction because there was a contemporaneous exchange of new value, the court also found that the creditor had an equitable lien under Pennsylvania law. Of course, like the cases cited by Travellers, *Lewis* involved a creditor who made improvements to real property and the equitable lien was invoked to avoid unjust enrichment to the debtor. *Id.* at 950-951. I do not believe that *Lewis* is authority for invoking an equitable lien theory to a disputed transaction otherwise governed by both U.C.C. Article 9 and specific provisions of the Bankruptcy Code. In any event, because I find that the facts here clearly do not warrant the finding of an equitable lien, I need not decide whether an equitable lien theory is cognizable in the context of a § 547 action.

[19] Section 547(c)(1) provides:

> (1) to the extent that such transfer was
>
> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
>
> (B) in fact a substantially contemporaneous exchange;

11 U.S.C. § 547(c)(1) (West 1993).

previously transferred to such transferee," Travellers argues that pursuant to the Stipulation it released its right to obtain a judicial lien for the amount of its judgment in exchange for the Cash Deposit.

Travellers' new value exception argument suffers from the same defects as its equitable lien argument. TWA never obligated itself to create the Cash Deposit. Only if it wanted a stay of execution after November 4, 1991 was it obligated to post a bond or make the deposit of cash. It could elect to do neither. Furthermore, Travellers did not release its right to obtain a judicial lien for the amount of the judgment in exchange for the alleged promise of a Cash Deposit. As noted in the discussion of Travellers' equitable lien argument, *supra*, there was no forbearance to obtain a judicial lien and, even assuming there was some type of forbearance, it was not the forbearance of a right which had any demonstrable value.

Even if it were supported by the facts, Travellers new value argument fails as a matter of law. A creditor's forbearance from levying on a judgment was found not to constitute "new value" under § 547(a)(2) in *In re Thomson McKinnon Sec. Inc.*, 125 B.R. 94 (Bankr. S.D.N.Y. 1991). That court relied on the Eleventh Circuit's statement that "[f]orbearance from exercising pre-existing rights does not constitute new value," *See In re Air Conditioning Inc. of Stuart*, 845 F.2d 293, 298 (11th Cir.), *cert denied, sub nom* 488 U.S. 993, 109 S.Ct. 557 (1988), to hold that the plaintiffs' forbearance from levying on a judgment against a defendant/debtor did not create "money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred." *McKinnon*, 125 B.R. at 97. In *McKinnon*, the plaintiffs had deferred levying on the defendant's assets in expectation of the defendant's posting a cash

deposit with the clerk of court to obtain a stay of execution pending appeal, which the defendant did two days prior to filing for bankruptcy. *Id.* The court reasoned that the plaintiffs' forbearance did not enhance the value of the debtor's estate, as the debtors' right to appeal the judgment "was not an asset for the benefit of its creditors that could reasonably offset the diminution of its estate upon the execution of the judgment." *Id.*

Other courts have similarly held that the new value exception applies only where "new value" given to the debtor replenishes the estate for the value removed by the tranfer, and thus does not apply to the forbearance from exercising a previously existing right against the debtor. *See e.g., Drabkin v. A.I. Credit Corp.*, 800 F.2d 1153 (D.C. Cir. 1986) (forbearance from exercising right to cancel debtor's insurance coverage not "new value"); *Jones v. Society Bank & Trust (In re Riggs)*, 129 B.R. 494, 496 (Bankr. S.D. Ohio 1991) (creditor's forbearance of its preexisting right to repossess collateral following debtor's default, in exchange for permitting debtor to cure default, not "new value"); *In re Alithochrome Corp.*, 53 B.R. 906, 913 (Bankr. S.D.N.Y. 1985) (creditor's forbearance from enforcing a judgment as part of an out-of-court settlement not "new value").[20]

Furthermore, the Third Circuit has held that the party claiming that new value was contemporaneously exchanged must prove the specific measure of the new value given to the debtor in the exchange, reasoning that the language "money or money's worth in goods, services, or new credit" necessarily requires a specific dollar

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[20] I do not address the string citation of cases which Travellers sets forth in its post-trial brief on this issue. None of them support the proposition which Travellers fosters.

valuation of the "new value". *In re Spada (Creditors' Committee v. Spada)*, 903 F.2d 971, 976 (3d Cir. 1990). Even assuming Travellers had given something to TWA which could constitute "new value", Travellers has presented no evidence as to its "specific dollar valuation". *See id.*

## PART II – INSOLVENCY

Section 547(b)(3) requires that to avoid the transfer TWA must have been insolvent on November 4, 1991, the date of the transfer. Although § 547(f) creates a presumption of insolvency for the 90 day preference period, once the creditor puts in evidence to rebut that presumption, which Travellers did in this case, the burden of proving insolvency rests with the debtor. *In re Total Technical Servs., Inc. (Total Technical Servs., Inc. v. Whitworth)*, 150 B.R. 893, 899 (Bankr.D.Del. 1993), citing *In re Old World Cone Co.*, 119 B.R. 473, 477-78 (Bankr.E.D.Pa. 1990) and 4 *Collier on Bankruptcy* ¶ 547.06, at 547-38 to 547-39 (15th ed. 1991). *See also*, Notes of Committee on the Judiciary, S.Rep. No. 989, 95th Cong., 2d Sess. 89 (1978), *reprinted at* 1978 U.S.C.C.A.N. 5787, 5875; H.R. Rep. No. 595, 95th Cong., 2d Sess. 375 (1977), *reprinted at* 1978 U.S.C.C.A.N. 6331. The debtor must prove insolvency by a preponderance of the evidence. *See, e.g., In re OEM Indus. Corp. (OEM Indus. Corp. v. Birmingham Square)*, 148 B.R. 436, 438 (Bankr. W.D.Pa. 1992); *Old World Cone Co.*, 119 B.R. at 478. Section 101(32)(A) defines insolvency of a corporate debtor as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation".

The parties are poles apart on the issue of insolvency, with TWA claiming that the aggregate debts exceeded the

property value by $2,342,686, while Travellers claims that the property value exceeded the aggregate debts by $1,749,174. For purposes of the insolvency analysis, both parties use TWA's October 31, 1991 balance sheet as a reference point. Both parties agree that between October 31, 1991 and November 4, 1991 no measurable changes occurred in the nature or value of assets and liabilities. Compared to TWA's balance sheet as of October 31, 1991 the parties positions are as follows as to the TWA assets and liabilities:

| | *10/31/91 Balance Sheet (000)* | *TWA's Values (000)*[21] | *Travellers' Values (000)* |
|---|---|---|---|
| Assets | $2,924,187 | $2,561,366 | $6,707,143 |
| Liabilities | $3,480,762 | 4,904,052 | 4,957,969 |
| (Deficit) or Surplus | (556,575) | (2,342,686) | 1,749,174 |

While there are substantial differences between the parties on the amount of debts, the principal difference between the parties is the value of assets. I will therefore address the asset valuation issue first.

## ASSET VALUATION

*The Valuation Standard*

The central issue here is what is meant by the term "at fair valuation" in § 101(32). The parties agree that the

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[21] TWA presented a range of values. These figures represent the midpoints of the range.

asset valuation is not based on a foreclosure or auction sale scenarios. The parties agree that the valuation should be done on a "going concern" basis. The conflict arises because Travellers argues that TWA's approach is actually a liquidation valuation, not a going concern valuation. TWA, in turn, argues that Travellers' approach is a theoretical valuation which does not address the reality of converting non-cash assets into cash in order to pay creditors.

The parties agree that for a § 101(32) insolvency analysis, balance sheet numbers do not necessarily reflect the fair value of assets. Indeed, with limited exceptions, e.g., cash and cash equivalents, balance sheet asset numbers do not in fact reflect the fair value of the assets. Furthermore, there are some assets of substantial value which are not even listed on the asset side of TWA's balance sheet. Thus, the balance sheet is merely a starting point for the analysis.[22] From the balance sheet listing of assets each party made adjustments, additions and deletions based on the expert testimony of their respective appraisers and accountants.

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[22]Section 101(32) is often referred to as the "balance sheet" test of insolvency to distinguish it from the equity test, i.e., the inability to pay debts as they mature. *See generally, In re Bellanca Aircraft Corp. (Berqquist v. Anderson-Greenwood Aviation Corp.)*, 56 B.R. 339, 384-385 (Bankr. D.Minn. 1985); 4 Collier on Bankruptcy ¶ 547.26 at 547-94 (15th ed. 1983). To label it a "balance sheet" test may be a misnomer. Financial statements prepared in accordance with Generally Accepted Accounting Principles ("GAAP") do not record assets at fair market value. Instead, they are recorded at the historical, original purchase cost and reduced each year by an estimate of depreciation. Within the contemplation of § 101(32) "property" may include assets not even listed on the balance sheet. Debts are recorded only to the extent they are known and quantifiable; many nonrecorded liabilities usually surface in an insolvency analysis. As demonstrated herein, the balance sheet is only the starting point in the analysis.

Each party presented reports and testimony by aviation industry valuation experts as to the value of TWA's operating assets. TWA's expert was Avmark Inc. ("Avmark"); Travellers' expert was Global Aviation Associates, Ltd. ("Global"). Generally speaking, TWA's expert values were based on the assumption that the categories of assets would be converted to cash over a 12 to 18 month period. Travellers' expert opined as to the present, i.e., November 4, 1991, fair value of the assets without offering an opinion as to how long it might take for TWA to sell a particular asset or particular categories of assets to convert them to cash to pay creditors. In other words, Travellers' expert focused on the value of the assets "in place" to TWA.

As presented in its opening post-trial brief, Travellers states its criticism of TWA's approach as follows:

> Based on a clipped quotation from *Collier on Bankruptcy*, TWA says the "fair value" of its assets is the amount that it would receive if its assets were converted to cash over a reasonable time. . . . TWA further perverts this general statement by asserting that "fair value" should reflect two unwarranted and unsupportable assumptions. First, TWA contends that the fair-value standard requires its assets to be "converted to cash" in a hypothetical sale (*i.e.*, liquidation) of all assets that can be "sold." Second, TWA asserts that this sale must occur within a reasonable time, which TWA arbitrarily sets at 12 to 18 months.
>
> Neither assumption is legitimate, and both are inconsistent with the requirement that assets be valued from the perspective of a going concern.

Def. Br. 45.

In support of its position that to determine fair value one need not determine the cash that would be realized if assets were actually sold, Travellers quotes from the leading bankruptcy law authority as follows:

> Negatively, it can be stated on the one hand that the statutory definition does not imply that a person can only be deemed solvent at a particular time when the amount which he or his creditors would be able to *actually obtain* at the time is sufficient to pay all his debts then existing. Otherwise the controlling test would possess greater stringency than the one applicable under the traditional equity concept of insolvency, a result which the framers of the clause definitely intended to obviate. Rather, the underlying policy requires disregard of, and allowances for, unavoidable sacrifices or other adverse effects caused by the particular distress of the debtor. Accordingly, "*saleable value and fair value are not synonymous.*" (Footnotes omitted.)

2 *Collier on Bankruptcy* ¶ 101.32 at 101-106 (15th ed. 1992) (emphasis added by Travellers).

Travellers also asserts that numerous authorities cited by *Colliers* and elsewhere establish that the concept of reasonable time in the various formulations of the term "fair value" does no more than refer to the lack of any time constraint or other compulsion to sell.

In response to this position, TWA quotes from *Collier* as follows:

> In general [fair valuation] . . . will signify the reasonable estimate of what can be realized from the assets by converting them into, or reducing them to cash, under carefully guarded if not idealized conditions. . . .

and

> . . . direct[s] the estimate of what can be realized out of the assets within a reasonable time either through collection or sale at the regular market value, conceiving the latter as the amount that could be obtained for the property in question within such period by a "capable and diligent business man" from an interested buyer "who is willing to purchase under the ordinary selling conditions. (Footnotes omitted.)

2 *Collier on Bankruptcy* ¶ 101.32 at 101-106 and 101-108 (15th ed. 1992).

Thus, TWA argues that the valuation does require a determination of the amount of cash that can be realized from the assets and, according to TWA, Travellers' lack of any time constraint has the effect of reading out of the proposition a reasonable period of time and substituting a no time concept which results in theoretical values unrelated to the realities of the debtor's position in the industry.

Each party is able to quote *Collier* in support of their conflicting positions because *Collier's* discussion of insolvency includes an amalgamation of cases running back over the last 90 years and the cases are not all consistent. *See generally*, 2 *Collier on Bankruptcy* ¶ 101.32 at 101-105 through 101-117 (15th ed. 1994). The conflicting quotes from *Collier* arise not only from not well articulated reformulations of the insolvency test, but from the application of the test to broadly disparate fact situations. In addition, the very old cases were decided in a commercial context which has little resemblance to that of today. Finally, the value of cases decided before the 1934 introduction of the reorganization concept into non-railroad bankruptcy law, must be viewed with some degree of caution.

Before discussing some of the most often cited cases on "going concern" valuation of assets, I start by comparing the Code definition of "insolvency" with the former Bankruptcy Act's definition of "insolvency". In relevant part, § 101(32)(A) defines an insolvent corporate debtor as one whose "financial condition [is] such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." In relevant part, § 1(19) of the Act states that "a person shall be deemed insolvent . . . whenever the aggregate of his property . . . shall not at a fair valuation be sufficient in amount to pay his debts." Despite the language change, there is nothing in the legislative history of the Code to suggest that Congress intended to change the meaning of "insolvent" from that found in the Act, and pre-Code cases continue to be relied upon.

*Collier* refers to the "overwhelming authority" which calls for a going concern valuation, absent a "deathbed" situation. 2 *Collier on Bankruptcy*, ¶ 101.32 at 101-115 to 101-116 (15th ed. 1994). I briefly examine four of *Collier's* authorities. These are cases which are frequently cited for the "going concern" proposition.[23]

1. In *Chicago Title & Trust Co. v. John A. Roebling's Sons Co.*, 107 F. 71 (C.C.N.D. Ill. 1901), the court found no error in a master's report which concluded that a judgment creditor did not obtain a preference when it caused

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[23]Many of the cases cited by *Collier* contain no meaningful discussion of the "going concern" concept. *See In re Bucyrus Road Machinery Co.*, 10 F.2d 333 (6th Cir. 1926); *Meyer v. Dolan*, 145 F.2d 880 (2d Cir. 1994) *cert. denied*, 324 U.S. 867 (1945); *In re Reading Hotel Corp.*, 10 F.Supp. 470 (D. Pa. 1935); *In re Gibson Hotels*, 24 F.Supp. 859 (D. W. Va. 1938); *Dabney v. Chase Nat'l Bank of the City of New York*, 196 F.2d 668 (2d Cir. 1952) *cert. dismissed*, 346 U.S. 863 (1953). Only the cases containing a meaningful discussion of the concept are examined herein.

execution on its judgment by a sheriff's sale. The sheriff's sale destroyed the value of the debtor's manufacturing plant as a going concern and the court found that for purposes of the insolvency test the debtor's property should be valued as a going concern before the sheriff's sale. The opinion does not disclose how the master arrived at the going concern value, although the going concern value precise figure of $41,473.19 suggests that it might have simply been a book value figure.

2. In *Rutland County Nat. Bank v. Graves*, 156 F. 168 (D. Vt. 1907), the court rejected the finding of a referee that the debtor intended a preferential transfer. At the time of the transfer an individual debtor was operating a business and also held a substantial receivable from a lumber mill company. After the transfer, the lumber mill was destroyed by fire and the mill property was uninsured. This was the immediate cause of the debtor's bankruptcy. The referee equated the fair value of the debtor's property to the amount it brought in a bankrupt auction sale and assumed the receivable from the lumber company was worthless. Not surprisingly, the court rejected the referee's determination, concluding that the pre-petition going concern value of the debtor's property, not the bankrupt auction sale, was the test for insolvency on the date of the transfer.

3. In *In Re Nathanson Bros. Co.*, 64 F.2d 912 (6th Cir. 1933), the court affirmed a master's finding of solvency which resulted in the dismissal of an involuntary petition. The court approved of the master's going concern valuation but the brief opinion contains no discussion of the master's determination. The opinion does set forth a statement, subsequently quoted in other opinions, as to what going concern value means, namely:

> Doubtless the underlying principle of going concern value is that an additional element of value attaches to property, considered in the aggregate, by reason of its having been assembled for the conduct of the given business and its fitness for such use. We do not think that the financial outlook of the debtor corporation, or the intention of its stockholders and directors to continue business or to liquidate at an early date, is determinative of the question. If the business is in fact being conducted at the time of alleged bankruptcy, then the items of property constituting its assets must receive a fair valuation, not as isolated articles separated from the whole, but as parts of the whole and as useful in that relationship. This is all that is meant by going concern value.

*Id.* at 913. I find this often quoted going concern value explanation not helpful for present purposes. Indeed, I am puzzled by the suggestion that "the financial outlook of the debtor corporation" is not determinative of the question.

4. In *In Re Ouellette*, 98 F. Supp. 941 (D.Me. 1951), the court affirmed the referee's finding of insolvency based on an expert appraiser's opinion as to the value of the debtor's inventory versus the debtor's argument that the inventory should be valued on the basis of a higher cost figure. The expert's opinion was based on what he believed a willing buyer would pay for the debtor's store, including inventory, to take it over and operate it. The opinion does not use the term "going concern" but does define "fair value" as follows:

> "Fair value" is not the valuation that would prevail at a sheriff's sale, sacrifice, or forced sale, nor is it the value to one person or another specially circumstanced. "Fair value" means such a price as a capable and intelligent business man could presently

> obtain for the property from a ready and willing buyer accustomed to buying such property. Such a value will depend upon many circumstances, such as age and condition of the stock, the state of trade, location of the business, the existence of a lease, and many other things. See Stern v. Paper, D.C. 19010, 183 F. 228. No one factor alone is conclusive.

*Id.* at 943.

I find *Collier's* case citations on "going concern" value for insolvency purposes not very enlightening in attempting to understand Travellers' position. As to the pre 1934 cases, it may be argued that the courts were merely saying that since insolvency was to be tested as of a pre-petition date; the bankruptcy status, with the resulting forced liquidation sale, was not to be considered. This is clearly what the court was saying in *Rutland County Nat. Bank, supra.* The only point I find clearly established by these cases is that fair valuation does not imply a foreclosure, auction or distress sale.

I turn next to an examination of four cases relied upon by Travellers for the proposition that an asset's fair value does not involve a conversion to cash through a sale with a time constraint.[24]

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[24] Many of the cases cited by Travellers contain no significant discussion of the fair valuation concept. *See Covey v. Commercial Nat. Bank of Peoria,* 960 F.2d 657, 660 (7th Cir. 1992); *Briden v. Foley, (In re Arrowhead Gardens, Inc.),* 32 B.R. 296, 299 (Bankr. D. Mass. 1983), *aff'd,* 776 F.2d 379, 382 (1st Cir. 1985); *Energy Co-Op., Inc. v. Cities Serv. Co., (In re Energy Co-op., Inc.),* 109 B.R. 822, 824 (N.D. Ill. 1989); *Murphy v. Valencia (In Re Duque Rodriguez),* 75 B.R. 829, 831 (Bankr. S.D. Fla. 1987); *DeRosa v. Buildex, Inc. (In re F & S Cent Mfg. Corp.),* 53 B.R. 842, 849 (Bankr. E.D.N.Y. 1985). Only the cases containing a significant discussion of the concept are examined herein.

1. In *Syracuse Engineering Co. v. Haight*, 110 F.2d 468 (2d Cir. 1940), the court affirmed the district court's finding of insolvency where the principal contested issue was how to value the individual debtor's interest in a trust. Because the decision involved unique state law and insurance law issues regarding the trust and the debtor's projected stream of income from the trust, its discussion of the facts is not helpful here. The court stated the law as to fair valuation as follows:

> Fair valuation of an estate such as this might conceivably be based on forced sale prices, or on fair market prices, or on so-called intrinsic values, irrespective of sale. A proper regard for the interests of the bankrupt, as well as for the interests of his creditors, compels the conclusion that fair market price is the most equitable standard. Bonbright and Pickett, Valuation to Determine Solvency under the Bankruptcy Act, 29 Col.L.Rev. 582, 597, 598; 1 Collier on Bankruptcy (14th Ed. 1940) 74-81, collecting cases. It involves a value that can be made available for payment of debts *within a reasonable period of time.*

*Id.*, at 471 (emphasis added). Contrary to Travellers' argument, the case expressly states that a value estimate contemplates converting assets to cash to pay debts within a reasonable period of time.

2. In *Duncan v. Landis*, 106 F. 839 (3d Cir. 1901), the court reversed a jury finding of insolvency because it found the trial judge's instruction on the issue to be in error. In the jury instructions, the trial judge advised that in determining what a purchaser would pay for the property the jury should consider the debtor's "[financial] situation, and the number and amounts of obligations owing by her, the time when they were due, which, of course, are elements regarded by the purchaser." *Id.* at

858. The appellate court found the instruction to be in error because it suggested that the purchaser can take advantage of the necessities and embarrassments of the debtor. The opinion contains what I believe to be conflicting language, suggesting that a fair value determination does not require a sale of the property, while also commenting that such value may be sufficient to pay the debts, even if the debtor "might not be able to realize at once the amount of that valuation." *Id.* at 859. The pertinent portion of the opinion is as follows:

> We think that the present market value of the property in question would be a fair valuation of the same, but there is nothing in this section of the act that authorizes that market value to be ascertained by what a purchaser would give who desired to take advantage of the necessities and embarrassments of the owner, in order to procure the same at a price less than its real or market value. We think the words above quoted from the charge of the court below which we have italicized have no place in an explanation of what is the criterion of a fair valuation. Lawrence v. City of Boston, 119 Mass. 126; Dwight v. Commissioners, 11 Cush. 201; Railroad Co. v. Doughty, 22 N.J. Law, 495; Murray v. Stanton, 99 Mass. 348. Again, the act expressly says that a man shall be deemed insolvent only when the aggregate of his property, at a fair valuation, shall not be sufficient to pay his debts; but the court below gives an unwarranted construction to this definition, by adding to the plain meaning of a "fair valuation" the requirement that the debtor must be able to realize from his property a sufficient amount to pay his debts. This seems to us to clearly depart from the plain requirements of the statute, by adding a condition not therein set forth. *A man's property, at a fair valuation, may amount to sufficient*

> *to pay his debts, although he might not be able to realize at once the amount of that valuation.* In these two respects, we think the charge of the court, under this provision of the statute, misleading, and calculated to place the debtor in a harder situation than was intended by the statute.

*Id.* at 858-59 (emphasis added). Some may argue that *Duncan* stands for the proposition that a fair valuation determination does not require a conversion of the property into cash within any particular time frame. As I read the case, it simply stands for the proposition that fair value is not determined on the basis of a distress sale.

3. In *In Re Art Shirt*, 93 B.R. 333 (E.D. Pa. 1988), the court affirmed the bankruptcy court's finding of insolvency in a trustee's preference action. The decision is principally devoted to the issue of the inclusion of a pension plan withdrawal liability as a debt of the estate. The limited discussion of the valuation of assets I find not particularly instructive. The creditor claimed that the bankruptcy court failed to value the assets on a going concern basis. The district court agreed, stating that "[b]efore the going concern valuation is to be abandoned, the business must be "wholly inoperative, defunct or dead on its feet." *Id.* at 341. Because it found that the accounts receivable had to be reduced by $417,000, the inventory by $249,000, the physical assets by $57,000, and that the liabilities (other than the pension liability) had to be increased by $120,000, the court concluded that the debtor did not deserve to be valued as a going concern. This reasoning seems to suggest that the going concern label is a conclusion to be drawn from the numbers determinations, rather than vice versa.

4. In *Moody v. Security Pacific Business Credit, Inc.*, 971 F.2d 1056 (3d Cir. 1992), the court affirmed the

district court's finding that a leveraged buy-out a year and a half prior to the bankruptcy filing did not constitute a fraudulent conveyance and that the debtor was solvent at the time of the conveyance. The buyer paid $12.1 million for a company with a long history of profitable operations. The profitability continued immediately after the leveraged buy-out. However, the company's financial condition began to deteriorate approximately ten months before the bankruptcy petition. Sales fell off dramatically, inventory built up, cash flow constricted, large segments of the business were shut down and eventually an involuntary petition was filed. The case was later converted to Chapter 7 and the company was liquidated. On appeal, the trustee argued that in valuing property, plant and equipment ("PP&E") the district court erred in using a going concern approach. The court observed that "[w]here bankruptcy is not 'clearly imminent' on the date of the challenged conveyance, the weight of authority holds that assets should be valued on a going concern basis." *Id.* at 1067. According to the court of appeals, the district court's finding that the debtor was not a company whose failure was clearly imminent on the date of the conveyance was supported by the record which showed a balance sheet net worth of more than three times the liabilities, a positive cash flow and a break even year. The district court found a going concern value for PP&E of at least $5-6 million. That number was the lowest of five choices presented to it on the record.[25] Because the district court's selection of the

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[25] Values presented included: (1) a $17.7 million book value; (2) a two year old manufacturer's appraisal of $29 million; (3) the prior owner's $11 million of capital improvements; (4) the creditor's expert valuation of $13.7 million, and (5) the $5.65 million selling price received in selling off the PP&E component parts in

[footnote continued]

lowest of the five choices for the PP&E still resulted in a finding of solvency, the case is not very instructive on how to apply the going concern test.

As best as I can discern from its briefs, Travellers' position is that a going concern approach does not require consideration of what the assets could produce to pay creditors, but rather involves an "in place" value to the debtor on the assumption that the debtor will continue as a going concern for an indeterminate time and in some unexplained fashion and with no time constraints, pay off its creditors. I find no support for that concept in the cases relied upon by Travellers.

Travellers' argument on going concern valuation takes a confusing turn when it states in one of its post-trial briefs as follows:

> The going-concern assumption, as it applies to balance sheets, contemplates that assets will be converted to cash *through the normal operations of the company* and used to pay off liabilities *in the normal course of business.* Tr. 690, 762-63; Def. Ex. 3 at F-15. It does not contemplate a conversion of assets to cash by the process of a piecemeal liquidation. Rather, "assets must be valued, not as isolated articles separated from the whole, but as parts of the whole and as useful in that relationship." *In re Bellanca Aircraft Corp.*, 56 B.R. 339 at 396-97 (Bankr. D.Minn. 1985). (Traveller's emphasis.)

Def. Br. 7-8.

Travellers' citation to the record is to the testimony by TWA's accounting expert's comments on, and to TWA's

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three sale transactions, one shortly before the petition and two after it. The creditor offered no evidence on the going concern value because he argued that the entire company could not be worth more than the price paid for the stock.

December 31, 1991 financial statements reflecting, going concern accounting presentations. Travellers seriously confuses the analysis under the Code definition of "fair valuation" with accounting presentations called for by GAAP. Accounting conventions are not the controlling principles for the legal determination of whether a debtor's debts exceed the fair value of its assets for purposes of insolvency. *See In re F & S Central Manufacturing Corp.*, 53 B.R. 842, 849 (Bankr. E.D.N.Y. 1985) ("Asset values carried on a balance sheet, even if derived in accordance with 'generally accepted accounting principals,' do not necessarily reflect fair value: 'Generally accepted accounting principals' are not synonymous with any specific [valuation] policy.' ") (quoting *Pittsburgh Coke & Chemical Co. v. Bollo*, 560 F.2d 1089, 1092 (2d Cir. 1977)); *In re Arrowhead Gardens, Inc.*, 32 B.R. 296, 299 (Bankr. D.Mass. 1983) ("[A]n asset entry on a balance sheet may not necessarily be an asset for the purpose of determining insolvency even though it may be an appropriate entry in accounting terms."). In his report, Travellers' own accounting expert stated unequivocally that "GAAP does not permit the reflection of assets or liabilities at fair values." DX 72, p. 8.

If the accounting presentation dictated by GAAP were controlling here the trial of this matter, as well as this opinion, would have been brief. TWA's October 31, 1991 balance sheet shows debts exceeding assets by $557 million.[26]

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[26] As Travellers has demonstrated here, the "going concern" valuation concept can be easily confused with the "going concern" accounting presentation of GAAP. Indeed, in *Edward R. Bacan Company v. William B. Groves*, 420 F.2d 678 (9th Cir. 1970) the court appears to have done just that. In reliance upon *Collier's* statement that "overwhelming authority" requires the valuation of assets on a going concern basis, the court found the debtor to be

[footnote continued]

The fact that TWA's financial statements during 1991 continued to be presented on a GAAP basis with a going concern assumption does little to support an argument regarding TWA's then financial viability. TWA's auditor's opinion letter for the December 31, 1991 fiscal year end states that in light of the numerous financial problems (including debt defaults and recurring losses) there existed "substantial doubt about the entity's ability to continue as a going concern." PX1, p. F-3. The quoted statement from the opinion letter represents the strongest statement of doubt available to an auditor respecting a company's ability to continue its business operations. Indeed, the auditors made clear that absent the proposed debt restructuring the going concern assumption for TWA was in serious doubt. The facts and circumstances which resulted in the auditor's qualified opinion for December 31, 1991 were essentially the same as existed on November 4, 1991. Similar "substantial doubt" caveats are found in auditors' GAAP presentations with "going concern" assumptions in opinions issued in May 1991 with respect to the financial statements of Midway Airlines, Inc. and Pan Am Airlines, Inc. PX 74, p. F-2; PX 77, p. F-2-3. Both of those entities ceased operations and liquidated later in 1991 with only fractional recoveries by creditors.

I find nothing in the Code or the case law, other than isolated statement without analysis, to support Travellers' position that in making a "fair valuation" determination, the so called "going concern" approach does not involve a consideration of realizing value from the assets which

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solvent because the balance sheet showed a positive equity and "[t]he accountant testified that the books and the balance sheets accurately reflected the financial condition of the debtor as a going concern." *Id.* at 679.

value (cash) can be paid to creditors within a reasonable time period. Absent that consideration, the valuation becomes a theoretical exercise.[27] As the court observed in *Coated Sales*, 144 B.R. at 668, "fair market valuation entails a hypothetical sale, not a hypothetical company." Travellers' position does not say how creditors can benefit from asset values premised on optimal operations of a debtor which in fact is in financial distress. Like the preference creditor, other creditors can only benefit by being paid. Consequently, I conclude that in this case a § 547-(b)(3) insolvency analysis requires a determination of the amount of funds which could be generated by converting non-cash assets into cash.[28]

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[27] At numerous places in its brief, Travellers equates "fair value" with "fair market value." But the market concept is inconsistent with Travellers' approach to valuation. A market connotes a place of commercial activity in which property is bought and sold, or a bringing together of buyers and sellers to exchange consideration. Thus, a market approach to valuation is consistent with the view of the need to address the conversion of non-cash assets into cash.

[28] A determination of the amount of funds which could be generated by converting non-cash assets into cash in doing the insolvency analysis may not be required in all § 547(b) cases. For example, the preference creditor may be able to demonstrate that other creditors could be paid in full, by demonstrating an ability of the debtor to refinance all its debt, or obtain an equity infusion or a combination of both, to "take out" all the old debt. As demonstrated below, the record here clearly shows that a 100% "take out" of the old debt was not a realistic possibility in November, 1991. In *Covey*, *supra*, the court formulated the insolvency test as follows: "To decide whether a firm is insolvent within the meaning of § 548(a)(2)(B)(i), a court should ask: What would a buyer be willing to pay for the debtor's entire package of assets and liabilities? If the price is positive, the firm is solvent, if negative, insolvent." 960 F.2d at 660. Subsequent to trial, I invited the parties to consider whether the *Covey* case suggested a different approach for testing solvency and whether the record should be

[footnote continued]

I believe my conclusion here is supported by the analysis conducted by Travellers' accounting expert and set forth in his report. That expert started with the October 31, 1991 balance sheet, added the values assigned by Global, deducted book value duplications, and made additional adjustments to certain book values (discussed *infra*) to arrive at asset values for various categories of assets. He then deducted the book value tax bases of the assets and subjected the gain on sale of the assets as so valued to an assumed combined federal and state tax rate of 37.5% to reach an assumed net gain from the sale of assets. I find this exercise to be an acknowledgment of the need to convert non-cash assets to cash to see if the non-preference creditors could be made whole, i.e., fair as well as Travellers.[29]

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reopened to receive testimony on whether TWA could attract a positive price buyer on November 4, 1991. The parties saw no useful purpose to be served in such an exercise. Travellers felt that little concerning the solvency of a debtor could be inferred from such testimony. Such conclusory testimony would surely prompt a detailed analysis of the underlying asset values not unlike what the parties had already placed on the record. The *Covey* court's comment may be viewed as a different way to state the exercise already undertaken by the parties in this matter. One case suggests that a going concern value can be determined by capitalizing net profit. *In re Vadnais Lumber Supply, Inc.*, 100 B.R. 127, 131-33 (Bankr. D. Mass. 1989). I would agree that this could be an approach in demonstrating an ability to take out old debt with new money. However, a history of, and near term prospects for, net profits may not alone be sufficient to make the determination. For example, a currently profitable operating entity may have contingent or unliquidated environmental or tort liabilities which no knowing lender/investor would assume.

[29]Travellers' accounting expert's report states the purpose of, and assumptions involved in, his valuation task in terms which I find to be consistent with the approach which I adopt. His report states:

> As an overall assumption, the fair value of assets and liabilities has been predicated upon the fact that TWA was a going

[footnote continued]

While Travellers argues vigorously in its opening post-trial brief that "the determination of fair value does not require a determination of the cash that would be realized if assets were actually sold," Def. Br. 5, in its reply brief it claims that "Global's opinion of the assets' fair market values represents the amounts TWA's assets would fetch if a sale were negotiated within a reasonable time." Def. Reply Br. 8. At this point I must confess some confusion as to Travellers' position. Perhaps Travellers' first argument was prompted by the fact that Global's "reasonable time" is an obscure concept. According to Global, reasonable time here means that some assets "could be sold in two days, some in two years and some it might take five years." Tr. 356-60. Under the circumstances, I find TWA's 12-18 month conversion period to be a reasonable approach.[30]

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concern. Further, we have relied on the following definition of fair value for the purposes of including the assets at fair value from the leading bankruptcy commentator:

> ". . .Couching the mandates of fair valuation in positive terms it can be said that they direct the estimate of *what can be realized out of the assets within a reasonable time either through the collection or sale at the regular market value,* conceiving the latter as the amount which could be obtained for the property in question within such period by a 'capable and diligent business man' from an interested buyer 'who is willing to purchase under the ordinary selling conditions.' "

2 *Collier on Bankruptcy* at 101-104-05 (15th ed. 1992) (footnotes omitted). *We have also assumed the orderly repayment of liabilities.* It is further assumed that in connection with TWA's ongoing restructuring, which was taking place as of November 4, 1991, that certain assets would be disposed of and other operating modifications would be accomplished in the normal course of business and in an orderly fashion.

DX 72, p. 8. (emphasis added).

[30] A valuation based on a conversion to cash and payment to creditors over an extended period of time such as two to five

[footnote continued]

To the extent that Global's asset values reflect Travellers' valuation theory, I would be inclined to reject them. However, since Travellers' reply brief represents that those asset values are sale values, I will undertake a category by category examination of the conflicting valuations for operating assets as put forth by Avmark and Global.

*TWA's Condition on November 4, 1991.*

Before detailing specific reasons for my value conclusions on various categories of assets, I start by setting this matter in the appropriate context. As demonstrated by the following, TWA was a financially distressed entity in an industry in crisis as of November 4, 1991.

1. The year 1991 was a very poor one for the airline industry and by November, its condition was deteriorating seriously. In 1991 the industry had an operating loss, before debt payments, of approximately $3.8 billion. The outlook was that 1992 would be another poor year. A number of airlines were already in bankruptcy, including Pan Am, Eastern, Continental, Midway and American West and were trying to dispose of assets. There was a threat that bankrupt and financially weakened airlines would be selling more assets in the months and years following November 1991. The liquidation of airlines saturated the market for airline assets. Moreover, the industry had committed to purchase approximately $140 billion in new assets. In short, the airline industry in November 1991 was "depressed" and that depression was expected to persist for the foreseeable future.

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years ignores the time value of money. A 100% payment to other creditors which occurs years after a preference transfer is not the same as the 100% payment to the preference creditor.

2. By January 1991 TWA's domestic flight service was reduced by approximately 20% from that in January 1990 and international flight service was reduced by approximately 50%.

3. Because of its deep liquidity crisis, TWA was forced to stop making payments which were otherwise due under many of its equipment leases. It was also forced to withhold payments due and owing under its debt instruments. As of November 1991, TWA had withheld payments to its creditors of approximately $162.2 million, including approximately $158.9 million in principal and interest on its debt securities. As a result of TWA's failure to meet its payment obligations, many of its indenture trustees, noteholders and lessors declared defaults and accelerations of indebtedness. These actions in turn triggered cross-defaults and cross-accelerations in substantially all of TWA's debt obligations. Numerous creditors demanded remedies including termination of their arrangements with TWA, seizure of collateral, and return of leased equipment. A number of legal proceedings were brought by TWA's creditors against the company to enforce such remedies. For example, certain of TWA's creditors were enforcing remedies for seizure of approximately 30 of TWA's aircraft and related engines.

4. TWA was in severe financial condition in 1991 and its precipitous financial decline was especially acute by the third and fourth quarters of 1991. Its net working capital deficit, (i.e., the excess of current liabilities over current assets) exceeded $1.4 billion.[31] For the first nine

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[31] The large deficit was principally attributable to the reclassification of long term debt to current debt as a result of accelerations triggered by defaults. Nevertheless, if that debt were removed from the current debt calculation, TWA still had a working capital deficit of $110 million.

months of 1991, TWA had suffered an operating loss of some $258 million, losing approximately $1 million per day. As of September 30, 1991, approximately $340 million aggregate principal amount of TWA's indebtedness had been accelerated. The financial condition of TWA worsened between September 30, 1991 and November 4, 1991. In its Form 10-Q filed with the SEC in November 1991, TWA stated that absent a debt restructuring, it would exhaust its cash resources by mid-1992 if it brought its debt and lease obligations current.

5. Starting in February 1991 TWA commenced issuing a series of press releases which foretold of its January 1992 Chapter 11 filing. On February 1, 1991 it announced it was withholding payment of $75.5 million in principal and interest due on several issues of secured publicly traded debt and that it would immediately be contacting creditors to seek their cooperation in restructuring the debt. On April 21, 1991 it announced that summer bookings had improved substantially, that its cash position had stabilized, and that it now believed that it could survive the current difficult climate in the industry without the need for rehabilitation under Chapter 11. However, it announced on July 30, 1991, that following intensive negotiation it had reached preliminary agreement with groups of public noteholders to eliminate approximately $1 billion of debt. The restructuring would be accomplished through a prepackaged reorganization to be filed in early 1992. On October 14, 1991 TWA announced that negotiations for a financial restructuring were virtually complete. On November 8, 1991, TWA referred to "our 1992 restructuring." On January 31, 1992 TWA announced the filing of the peition for its "pre-planned Chapter 11 reorganization."

6. In November 1991, TWA's publicly traded debt was trading at steep discounts as follows:

| *Debt* | *Trading Price* (as a % of face value) |
|---|---|
| 14.25% equipment trusts due 1991-1996 | 68 |
| 15% Senior (secured) due 1994 | 49 |
| 17¼% Senior (unsecured) due 1993 | 21 |
| 12% (unsecured) due 2001 | 9 |
| 12% (unsecured) due 2008 | 8 |

7. With respect to TWA's December 31, 1991 financial statement its auditors opined that recurring losses, the pending Chapter 11 case, the need to achieve satisfactory levels of future operating results and cash flow, and the need to obtain additional capital raised substantial doubt about the entity's ability to continue as a going concern.

On the other hand, Travellers cites the following in support of its contention that TWA was a vibrant entity in November 1991.

1. In July 1991 TWA made an offer to purchase Pan American Airways.

2. In September 1991 TWA announced that it was seeking new authority to operate between New York and London.

3. In October 1991 TWA added Western Airlines, Inc. as a new commuter affiliate and announced a new Business Saver Program involving specially discounted coupons to purchase flights up through April 30, 1992.

4. On November 8, 1991 TWA filed its SEC third quarter report, in which it stated that it was continuing discussions with all creditor groups to finalize a restruc-

turing plan, and stated that in the interim "TWA intends to conduct business as usual and continue normal operations including . . . flight operations, honoring tickets and Frequent Flight Bonus program credits. TWA also intends to pay all of its trade creditors and to honor its lease and debt obligations that have already been restructured". DX 5 at 38-39. TWA's chairman stated that restructuring of debt and the renegotiation of leases "should position TWA as a formidable competitor in 1992 and beyond". DX 22.

5. In November 1991 TWA announced new, and lower, international business fares, that would be valid for travel completed by March 31, 1992, announced the initiation of a new business flyer award club, and heralded an agreement to purchase all of the assets of Pan Am Express, a commuter airline with feeder routes into TWA's New York-JFK hub. TWA's chairman referred to the acquisition as an "important step in the expansion of TWA's domestic operations and . . . a significant cog in our new JFK domestic hub".

6. In December 1991 the purchase of Pan Am Express was consummated and TWA immediately introduced new service to Florida and the Bahamas. It also announced new, lower fares to Europe (which were valid for travel completed before April 7, 1992), the completion of negotiations to lease three additional Boeing B-767s, and continuing negotiations to acquire or lease more aircraft.

7. In January 1992 TWA announced new business fares for tickets issued before May 20, 1992.

8. In announcing the January 31, 1992 filing of its Chapter 11 petition, TWA assured creditors and the flying public that the conduct of TWA's normal business affairs would in no way be affected by the filing and that

TWA had on hand and available a total of approximately $500 million, consisting of cash on hand, and an additional $100 million to be received within approximately 30 days from previously announced asset sales, and up to an additional $200 million from debtor-in-possession financing which was to be arranged.

I attach very little weight to Travellers' list of "positives". For the most part, each of them falls into one of two categories—public relations puff or "rearranging the deck chairs on the Titanic."

Travellers dismisses the list of "negatives" up through November 4, 1991 as merely evidencing a liquidity problem, not insolvency. Travellers' position ignores reality. As early as July 1991, TWA announced what was probably already widely known in the marketplace: it was headed for the bankruptcy court because it had a debt load which exceeded the ability of its operations to handle. To have its debt load reflect its operations, it needed to eliminate $1 billion of debt. This was not proposed as a deferral of debt to solve a liquidity problem. It was to be a reduction. By November 1991 the situation had only worsened.[32] I find that as of November 4, 1991, absent a major financial restructuring, TWA was

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[32] As noted above in the discussion of Travellers' argument that it had a security interest in the Cash Deposit, in late October 1991 Travellers was hustling to secure, or absent that, to execute on, its $12,336,127 judgment. It was well aware that its ability to collect on its judgment was in jeopardy. This is not a case of a preference creditor receiving a past due payment unknowing of the debtor's financial crisis. Travellers' collection efforts were prompted by its knowledge of TWA's precarious financial condition. While under the Code, unlike the Act, there need be no finding that the preference creditor had reason to believe the debtor to be insolvent, the creditor's conduct in this case certainly can be considered as reflecting on the question of whether in fact the debtor was insolvent.

going the way of Eastern and Pan Am. The imminent filing of a Chapter 11 petition was inescapable. The only question remaining was whether TWA would come out of the Chapter 11 case as a reorganized entity.

Of course, TWA did come out of Chapter 11 as a reorganized entity—but the reorganization was neither quick nor painless for the creditors. Although TWA's press releases may have implied that the pre-filing debt restructuring terms were a "done deal," that was hardly the case. It took 20 months for TWA to obtain confirmation of its Plan and its terms incorporated only some of the pre-filing debt restructuring terms. Under the plan, the unsecured creditors, the class in which Travellers would have been but for the transfer, received less than $.20 on the dollar. TWA's equity holder was eliminated.

*Operating Assets Valuation*

Avmark's and Global's value opinions on various categories of operating assets, as compared to the October 31, 1991 balance sheet, are as follows:

| | *10/31/91 Balance Sheet (000)* | *Avmark's Values (000)* | *Global's Values (000)* | *Difference (Global Minus Avmark) (000)* |
|---|---|---|---|---|
| Routes | $ 0 | $490,160 | $743,000 | $252,840 |
| Gates and Slots | 0 | 460,400 | 904,000 | 443,600 |
| Maintenance Facilities | 138,490 | 45,091 | 407,000 | 361,909 |
| Aircraft | 631,208 | 430,592 | 640,400* | 209,808 |
| Spare Engines | | 96,110 | 122,000 | 25,890 |
| Spare Parts | 204,051 | 68,992 | 437,000 | 368,008 |
| Invest. in Affiliates | 116,951 | 166,770*** | 344,732 | 177,962 |
| Ground Equipment | 97,388 | 29,697 | 91,000 | 61,303 |
| Leased Flight Equipment | 473,141 | 0 | 473,141** | 473,141 |
| TOTALS | $1,661,229 | $1,787,812 | $4,162,273 | $2,374,461 |

*This figure excludes Travellers' valuation of $965 million for certain aircraft which TWA had on order. Since Travellers calculated an offsetting liability of the same amount, the net asset value of zero is not considered here.

**Global did not value this asset. Travellers argues for the balance sheet number.

***Avmark did not value this asset. TWA's value is based on other factors as discussed below.

I now turn to a comparative analysis of Avmark's and Global's valuations to make specific findings with respect to the value of each category of operating assets.

*Routes*:

Global valued TWA's international route authorities at $743 million, versus Avmark's $490.2 million. The many factors bearing upon the value of the route authorities makes an assessment of this asset difficult. Both appraisals are based on a number of very subjective determinations. However, I find a number of Global's determinations questionable. In its market method of valuation, Global used a mid-range multiplier based on "comparable" transactions. The high end of the range was weighted with two TWA-American Airlines transactions of questionable comparability. One was a December 1989 sale by TWA to American of its Chicago to London routes. Since Chicago is American's hub operation—and the routes therefore more valuable to American—this "comparable" distorts the valuation. As to the second TWA-American transaction, Global acknowledged that American probably overpaid for those routes. Global also relied upon "comparable" transactions that occurred in 1989 and 1990 and upon TWA's revenues from 1989 and 1990 in arriving at market values. The financial condition of the airline industry was significantly worse in 1991 than it had been in the prior two years. In valuing TWA's routes to Europe out of JFK Airport, Global acknowledged that TWA's domestic feed to JFK Airport subsidized the international routes. But the cost of that subsidy was not reflected in Global's valuation of those routes either in the market or income methods used.

Because I believe the above described deficiencies in Global's valuation compound the problem of subjective determinations in the route valuations, and since I do not

find similar deficiencies in Avmark's valuation, I adopt Avmark's value of $490.2 million for the route authorities.

*Gates and Slots*:

Global valued gates and slots at $904 million, almost twice Avmark's value of $460.4 million. Within this category, the largest gap is between Global's valuation of takeoff and landing slots at $237 million and Avmark's valuation of $88.4 million. I find significant deficiencies in Global's valuation to explain this gap. Global's expert had no prior experience in valuing slots.[33] To a significant degree, Global relied upon a February 1990 U.S. Department of Transportation study and a February 1989 study by an industry analyst. Both reports are based on a limited number of transactions and on market data seriously outdated relative to the industry's condition in November 1991. Furthermore, the U.S. Department of Transportation report expressly states that its analysis may overvalue slots where the carrier/buyer does not have gate and terminal capacity at the particular airport. Such an acknowledged shortcoming makes this source for Global's views of questionable value.

With respect to a number of slot transactions relied upon by Global which took place in 1991 the parties are sharply divided on how to interpret the transactions as they reflect the prices paid for slots. This difference results from the fact that either the slot sales were part of a package sale or the particular transaction was related to other dealings between the parties to the transaction. This conflict in interpreting a particular transaction underscores the difficult task of valuing assets whose

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[33] He likewise had no prior experience in valuing gates, and had limited prior experience in valuing routes.

value is tied into the existence of and value of other assets used in conjunction with gates and slots. Because I cannot conclude that Global's "comparable" transaction provide a proper guide here and because of my low level of comfort with Global's limited valuation experience in valuing slots and its reliance on outdated sources, I conclude that its valuation of slots is not reliable. I take more comfort in Avmark's methodology and therefore I adopt Avmark's slots value of $88.4 million.

The gap between Avmark's valuation of gates at $372.4 million and Global's valuation at $667 million is principally found in the approximately $200 million spread in their difference in the valuation of TWA's St. Louis and JFK facilities. I find Global's valuation of these two facilities fails to give adequate consideration to a number of significant factors. St. Louis is the hub of TWA operations. To realize maximum value, its gates would have to be sold as a hub operation, creating a very limited market for the property. Travellers argues that Global identified "four airlines that would be interested in establishing" a St. Louis hub. Def. Reply Br. 13. Travellers takes liberties with the language of the Global report. In its report, Global noted that "[w]hile most major carriers have established their hubs for the foreseeable future, a few [U.S. Air, American West, Continental and Northwest] *might* find St. Louis an attractive possibility." DX 67 at I-41. [emphasis added.] Not only does the language in Global's report not support Travellers' assertion, I find Global's observation about a potential buyer vague and speculative. The difficulty of finding a buyer for the St. Louis hub operation gates is not adequately addressed in Global's valuation of $203 million and I therefore adopt Avmark's valuation of $139.1 million.

As to JFK Airport, Global valued 32 gates at $217 million (i.e., $6.78 million per gate) based on (a) the estimated cost of constructing new gate facilities, (b) its assessment that TWA's high number of gates could command a premium price, and (c) a comparable Pan Am transaction at JFK Airport. I find Global's estimated construction cost to be based on a confusing reference in an industry publication. Furthermore, it is an estimate for new construction rather than for the existing TWA facilities at JFK. Additionally, Global does not explain what the premium is for the high number of TWA gates. Actually, I believe that the high number could have a negative impact on value because of the difficulty of the market absorbing a large number of gates in a limited period of time. Finally, Global's valuation of the TWA gates appears to be essentially based on a Pan Am sale of 32 gates for $217 million—$6.78 million per gate. Travellers argues that this transaction may even represent a conservative value figure because the Pan Am gates were purchased by Pan Am's pension plan and the pension plan trustee had a fiduciary duty to not overpay for such assets. I view the transaction differently. I view it as a non-arms length transaction. And, of course, we know that subsequent to the transaction Pan Am went out of business. More importantly, the transaction took place in 1989, when the level of distress in the industry was not nearly what it was in November 1991. For these reasons, I adopt Avmark's JFK gates valuation of $82 million. Accepting Global's valuation for gates other than St. Louis and JFK, I find the value for all the gates and slots to be $566 million.

*Maintenance Facilities*:

Global values TWA's maintenance facilities at almost 10 times the Avmark valuation—$407 million versus

$45.1 million. I find Global's valuation of $407 million to be seriously deficient. The valuation involved five facilities, with the major facilities at Kansas City and JFK representing 84% of the value. The Kansas City facility alone represents 66% of the value. Global's expert did not visit any of the facilities. His valuation was based on two methods—replacement cost and income stream. The market approach was not used because there had been no recent transactions involving major maintenance facilities.

For the replacement cost method, Global looked at current construction costs for similar facilities, calculated the total cost based on the square footage involved and then reduced the number by 50% for Kansas City and 75% for JFK to account for age and physical condition. Both facilities are approximately 35 years old and do not meet modern design requirements for such facilities. Reliance on the replacement cost method for valuing aged limited use improved real estate is, as a general proposition, risky. Given the extremely limited market for such facilities in the airline industry and the fact that Global did not even inspect them—I note that Avmark's expert testified that he was very familiar with these facilities and had done valuations of them in the past—I find Global's replacement cost method to be of dubious application here.

I take no greater comfort in Global's income method. For this method, Global relied upon information from the Port Authority of New York and New Jersey regarding revenue earned from contract maintenance performed at Pan Am's JFK facility. The Pan Am facility has been for sale for several years, and, according to Avmark, TWA's JFK facility is in worse condition than that of Pan Am. More importantly, in its own report Global raises serious doubt as to the reliability of the Pan Am JFK facility information. According to Global, "[t]he data

used in the income approach is based *solely* on Pan Am's facility which *may not* necessarily be representative of the industry *or even that accurate*." DX 67 at III-7. (emphasis added.) Given such a sweeping caveat, I decline to accept Global's income method opinion as probative of the value of TWA's maintenance facilities.[34]

Because of what I find to be serious deficiencies in Global's valuation of TWA's maintenance facilities, I adopt what I believe to be the more realistic Avmark value of $45.1 million.

*Aircraft and Spare Engines*:

TWA claims a value of $526.7 million, versus Travellers' value of $762.4 million, for TWA's aircraft and spare engines. Both experts agreed as to the dismal state of the market and as to TWA's aging fleet. They agreed that at November 1991 (a) there was a huge oversupply of used aircraft, (b) prices were expected to fall, (c) TWA's fleet was aging and inefficient and its average age was extremely high, (d) TWA's stage II aircraft have a limited useful life, and (e) the industry had made substantial commitments to purchase newer, more efficient wide-bodied planes. Global's value exceeded Avmark's by 45%. Based on their reports and the testimony of the two

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[34] As noted above, Global's valuation of the maintenance facilities produced a number almost 10 times that of Avmark's valuation. Although the differences were not as dramatic, these experts were also poles apart in their valuations of routes, gates and slots and spare parts. Expert testimony is offered to assist the court in making finding of fact on subjects as to which the court is obviously not an expert. When experts offer widely disparate valuations, the question arises as to whether the integrity of the process is being compromised. When I find what I consider to be gross deficiencies in aspects of the valuation methodology, my level of comfort with the testimony in general of that expert is diminished.

appraisal experts, I find it difficult to arrive at a finding of value for this category of assets. However, based on other evidence, I am lead to conclude that Global's value is inflated.

Global valued 10 of the aircraft and 65 related engine spares at $128 million. These 10 aircraft and 65 related engine spares served as collateral securing TWA's Equipment Trust Certificates due in 1991 and 1996. The face amount of the Equipment Trust Certificates outstanding in November 1991 was $53.6 million and they were being publicly traded at $.68 on the dollar. Thus, the market valued these securities at $36.5 million at a time when Global insists the underlying collateral had a value of $128 million. This difference cannot be accounted for by the changing interest rates.[35] Given the short maturity of the securities, it is obvious that the market did not believe that the underlying collateral had a liquidation value of $53.6 million or more. To conclude, nevertheless, as Global did, that the collateral had a fair value of $128 million seems quite implausible to me. If the fair market value of the collateral is 234% of the book amount of the debt secured by the collateral, how is it possible to purchase the debt at 68% of its book amount? If the public debt holders viewed the asset values as Global did, then the debt would have been trading much closer to its face value. Even if one were to assume a 50% loss of value in a foreclosure sale, this would be so. Conversely, if the debt market was right, then Global is wrong. In my view,

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[35]The parties agree that the steep discount trading prices for TWA's publicly held debt was not attributable to changed market interest rates. Market interest rates were lower in late 1991 than when the debt instruments were originally issued in 1986-88. Thus, solely on the basis of the market interest rates the obligations should have been trading at premiums in late 1991.

this limited empirical evidence far outweighs the expert's subjectively influenced determination and it leads me to conclude that Global's aircraft and spares value is inflated. I therefore find that, at most, the value of the aircraft and engine spares should not exceed the Avmark value of $526.7 million.

Travellers argues that the steeply discounted trading prices for TWA's debt did not reflect collateral value or TWA's insolvency. In support of this position, Travellers offers two arguments. First, Travellers claims that "[t]he market was not likely to attribute a market price based on a going concern scenario, but instead necessarily took a more conservative approach and valued the assets at a reasonable estimate of their short-term liquidation value." Doc. #115 at 5. I view it differently. I believe the market viewed TWA's going concern prospects, absent a debt restructuring, as dim. The conclusion is inescapable that these obligations were viewed as high risk and therefore the value of the underlying collateral was being assessed by the market. While a foreclosure scenario might explain some portion of the discount, I believe it does not explain most of it. The difference is too dramatic. Second, Travellers argues that the debt instruments arose out of the leveraged buy out which took TWA private in the mid 1980s, and because those debt instruments were of "junk" quality, in reality they should be viewed not as debt but as equity. Indeed, by this approach, Travellers would reclassify $672 million of unsecured subordinated debt, call it equity and thereby have available more assets to satisfy "real" debt. Travellers approach turns the insolvency analysis into an Alice in Wonderland semantics exercise. It has no basis whatsoever in statutory or case law authority and I reject it.

*Spare Parts Inventory*:

As to this category of assets, the parties are far apart, with TWA valuing the spare parts at $69 million and Travellers at $437 million. Travellers' value is more than six times that of Avmark. Probably no category of tangible assets on the balance sheet of a distressed company is more suspect of value than inventory. Global's valuation of $437 million is a replacement asset valuation and Global's testimony as to what could be realized in terms of sale at any time was vague and confusing. Much of the inventory consists of used parts, not new ones. Because of the very thin market for such a large quantity of inventory and bearing in mind that the spare parts are, for the most part, for outdated aircraft of limited life, I believe that Global's replacement cost valuation is unrealistic.

Like the situation discussed above with respect to aircraft and engine spares, I find the opinion of the market place to be persuasive on the issue of value for spare parts. TWA's 15% Senior Secured Notes due 1994 were secured by TWA's spare parts and landing slots. Global valued the spare parts at $437 million and the slots at $237 million, for a total of $674 million. The face value of the 15% Senior Secured Notes was $262 million, and in November 1991 they were trading at less than $.50 on the dollar. Thus, the market was valuing the collateral at less than $131 million, or approximately 30% of Global's valuation of the spare parts collateral alone. As noted above, this situation is not attributable to the difference between the 15% coupon rate of interest and the then current market rate of interest. I conclude that it is explained by the market place's assessment of collateral value substantially under that opined by Global.

Avmark's value of $69 million represents a rationally explained alternative to Global's unrealistic and inadequately explained value of $437 million. I adopt the $69 million value for spare parts.

*Investments in Affiliates:*

The parties are also quite far apart in their valuation of TWA's investments in affiliates, with TWA claiming a value of $166.8 million and Travellers claiming a value of more than twice that, or $344.7 million. These investments consist of four separate assets. As to two of them, namely, Travel Marketing Corporation and "Other Affiliates," the parties are in agreement as to an aggregate value of $82.7 million. The two assets on which the parties disagree are Worldspan, a computer reservation system in which TWA has a 25% partnership interest, and Getaway Vacations, a wholly-owned subsidiary operating a group tour service. TWA values Worldspan at $84 million and Travellers values it at $200 million. TWA values Getaway at $0 and Travellers values it at $62 million.

Global valued Worldspan by analyzing seven market transactions involving the transfer of interests in the four major domestic computer reservation systems. From these transactions Global concluded that the value of each market-share point was $42.6 million. Since Worldspan's market share was 21%, Global concluded that Worldspan value was $896 million ($42.6 million X 21). Global then "conservatively" reduced that number to $800 million. Since TWA owns 25% of Worldspan, Global concluded that TWA's interest in Worldspan is worth $200 million.

Avmark did not value the Worldspan interest. TWA asserts that the Global valuation is based on speculative or hypothetical markets, a claim which Travellers disputes. TWA takes a different approach to valuing its Worldspan interest. The Worldspan partnership agreement contains a restriction on the transferability of TWA's partnership interest. In November 1991 TWA was in default under the partnership agreement in the amount of $27 million. This represented eleven monthly payments. If the default continued for twelve months, the other partners had a right to acquire TWA's interest based on a pricing formula which produced a figure of approximately $84 million. However, the full twelve months default was not complete in November 1991 and in December 1991 the total arrearage was paid by TWA. Under the circumstances, I cannot conclude that the partnership agreement buy-out price of $84 million represents a ceiling on the value. In the absence of any other valuation approach being offered by TWA, I will adopt Global's value of $200 million.

Travellers' valuation of Getaway was conducted by an individual experienced in tour operations. Based on an income stream analysis, Travellers' expert arrived at a value of $62 million. TWA did not offer an expert opinion on the value of Gateway. Relying on Gateway's 1991 balance sheet showing a negative shareholder equity of almost $4 million, TWA claims the value is zero. Travellers' expert discounted the balance sheet evidence on the grounds that (a) 1991 was an unusually bad year for tour companies because of the Persian Gulf War and (b) it is a cash flow business and the balance sheet numbers are not particularly relevant. While I find Travellers' expert's analysis to be premised on certain optimistic assumptions about profit margins and market share, since TWA offered

no evidence other than the Getaway balance sheet–which I find to be of little probative weight–I find the most probative evidence is that offered by Travellers and I therefore find Getaway to have a value of $62 million.

*Ground Equipment*:

Compared to a book value of $97.4 million, Avmark determined the fair market value of ground equipment to be $29.7 million. Avmark found much of the ground equipment to be old, in poor condition and probably having value only to TWA. Global concluded that the ground equipment had an in use value of $91 million. However, it had no opinion as to the value which could be achieved in a sale of those assets within a reasonable period of time[36] and, indeed, it did not disagree with Avmark's sale value. I agree with Avmark's market value approach and conclude that the ground equipment had a value of $29.7 million.

*Leased Flight Equipment*:

This item is carried on the October 30, 1991 balance sheet at $473.1 million. Avmark opined that given the market conditions (i.e., the market lease rates) as of November 4, 1991, TWA's leasehold interests had no value. Global did not value the leased flight equipment for Travellers. Travellers cites testimony by its accounting expert to suggest that the GAAP reporting of this item on TWA's balance sheet reflects fair value. For the same

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[36] I cannot reconcile this Global testimony with Travellers' claim that "Global's opinion of the assets' fair market values represents the amounts TWA's assets would fetch if a sale were negotiated within a reasonable time." Def. Reply Br. 8. Indeed, when it came to opining on how much various categories of assets would fetch in a sale within a reasonable period of time, I found Global's testimony generally to be equivocal and in several instances inconsistent with prior deposition testimony.

reasons discussed above regarding balance sheet "values," I am not persuaded. I find that the only probative evidence on the issue is Avmark's expert opinion and I therefore find that the leased aircraft had no value.

In summary, the above described analyses of Avmark's and Global's valuations leads me to conclude that the value of TWA's operating assets as of November 4, 1991, as compared to TWA's and Travellers' views, was follows:

| | *TWA (000)* | *Travellers (000)* | *Court (000)* |
|---|---|---|---|
| Routes | $490,160 | $743,000 | $490,160 |
| Gates and Slots | 460,400 | 904,000 | 566,000 |
| Maintenance Facilities | 45,091 | 407,000 | 45,091 |
| Aircraft and Spare Engines | 526,702 | 762,400 | 526,702 |
| Spare Parts Inventory | 68,992 | 437,000 | 68,992 |
| Investments in Affiliates | 166,770 | 344,732 | 344,732 |
| Ground Equipment | 29,697 | 91,000 | 29, 697 |
| Leased Flight Equipment | 0 | 473,141 | 0 |
| TOTAL | $1,787,812 | $4,162,273 | $2,071,374 |

*Non-Appraised Assets*

TWA's October 31, 1991 balance sheet contains several asset items which were not the subject of appraisal testi-

mony but as to which the parties disagree on their fair value. These are (a) prepaids and other deferred charges and (b) prepayment of flight equipment. I resolve the parties' differences on these items as follows.

*Prepaids and other deferred charges*:

Travellers' accounting expert accepted the $72.2 million GAAP book figure as the fair value of prepaids and other deferred charges. That, of course, is consistent with Travellers' argument that fair valuation is a going concern value without a liquidation within any period of time. TWA's accounting expert assigned a zero value to these assets because they could not be recoverable or convertible into cash within a reasonable time period. Because I hold that a § 101(32) insolvency analysis in the context of this case requires a consideration of the conversion of non-cash assets into cash within a reasonable period of time, I find that the prepaids and other deferred charges have no value.

*Prepayment of flight equipment*:

This item is carried on the October 30, 1991 balance sheet at $27.9 million. Travellers' accountant reduced it to $9.4 million. TWA argues that it should be reduced to zero because it was in default under the purchase agreement and therefore could not recover the prepayment. By reason of this fact, I find the value of this prepayment to be zero.

*Other Assets*:

There is no dispute as to fact that the balance sheet reflects the fair value of cash and cash equivalents of $402.4 million. While the accounting experts took different approaches in valuing various categories of accounts receivable, their net results were not significantly different. For purposes here, I adopt Travellers' figure of

$476.4 million. Likewise, as to other investments and receivables which Travellers valued at $175.7 million.

*Summary of Asset Values*

Based on my conclusions of operating asset values as recited above in comparing and analyzing Global's and Avmark's determinations, and combining those with the non-appraised assets and the balance sheet values as to which there is no dispute, I conclude that at November 4, 1991, the fair value of TWA's property was as follows:

| | (000) |
|---|---|
| Cash and cash equivalents | $402,373 |
| Accounts receivable | 476,362 |
| Routes | 490,160 |
| Gates and slots | 566,000 |
| Maintenance facilities | 45,091 |
| Aircraft and spare engines | 526,702 |
| Spare parts | 68,992 |
| Ground equipment | 29,697 |
| Investments in affiliates | 344,732 |
| Other investments and receivables | 175,702 |
| Total | $3,125,811 |

## DEBTS

With respect to the amount of TWA's liabilities as of November 4, 1991, the major differences between them are in the following categories:

| | *10/31/91 Balance Sheet (000)* | *TWA (000)* | *Travellers (000)* | *Difference (TWA minus Travellers) (000)* |
|---|---|---|---|---|
| Debt Obligations | $1,590,823 | $1,776,752 | $662,898 | $1,113,854 |
| Aircraft Lease Obligations | 813,604 | 595,000-<br>813,604 | 813,604 | (218,604)-<br>0 |
| Pension Plan Obligation | 112,958 | 219,419-<br>576,000 | 219,419* | 0-<br>356,581 |
| Med./Dental ben. oblig. | —— | 400,000 | 400,000 | —— |
| Contingent Liabilities | —— | 634,814 | —— | 634,814 |
| Totals | $2,517,385 | 3,625,985-<br>$4,201,170 | $2,095,921 | 1,530,064-<br>$2,105,249 |

*As explained below, there is some confusion as to Travellers' position on this obligation.

*Debt Obligations*

According to TWA's accounting expert, the debt obligations on November 4, 1991 consisted of the following three elements:

| | *Amount (000)* |
|---|---|
| Current maturities | $1,384,034 |
| Accrued interest | 206,789 |
| Unamortized discount on 12% Deb. | 185,929 |
| | $1,776,752 |

According to Travellers' accounting expert, the debt obligations amount to only $662.9 million due to TWA's ability to purchase public debt at trading prices substantially below the face amount of the debt. Before discussing Travellers' methodology for calculating public debt obligations, it is necessary to examine the parties' respective views on the determination of debt for purposes of a § 101(32) insolvency test.

"The term 'debt' contained in the definition of 'insolvent' must be construed in light of the meaning ascribed to it under Section 101(12)." 2 *Collier on Bankruptcy* ¶ 101.32[6] at 101-117 (15th ed. 1994). Section 101(12) defines "debt" as "liability on a claim." Clearly, as of October 31, 1992 debt holders had claims against TWA in the aggregate amount of $1,776,752,000, (including the $185.9 million of unamortized original issue discount) reflected in the face amount of the debt instruments. Nevertheless, because the publicly traded portions of TWA's debt were being traded at steep discounts, Travellers argues that such debt should be calculated at market prices. Travellers claims that "[n]umerous courts have stated that the Bankruptcy Code balance sheet test for

insolvency requires that liabilities be determined at their fair value," which in the case of publicly traded debt is the amount at which the debt is being traded, or the amount for which a creditor would be willing to sell the debt instrument. Def. Br. 19.

The "numerous" cases cited by Travellers do not support its position and its reliance on *Mellon Bank v. Metro Communications, Inc.*, 945 F.2d 635 (3d Cir. 1991), *cert. denied*, 112 S.Ct 1476 (1992) as "controlling" on its position is misplaced.[37]

Both *Covey v. Commercial Nat. Bank of Peoria, supra,* and *In re Xonics Photochemical, Inc.*, 841 F.2d 198 (7th Cir. 1988) are inapposite as they involved analyses of the probability of loan guarantee contingent liabilities. Neither case suggests that publicly traded debt should be subjected to a "fair valuation" analysis, and *Covey* clearly states that the amount of debt is determined from the debtor's perspective, not that of the creditor:

> The Bankruptcy Code requires us to assess things from the debtor's perspective. Consider a simple case. Debtor issues its note for $10 million. It has assets of $5 million, secured debt of $2 million, and no other debt. From the creditor's perspective this note is worth somewhat less than $3 million. (Collection is costly and uncertain). Together, Debtor's

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[37] Travellers' "numerous" cases are: *Covey v. Commercial Nat. Bank of Peoria*, 960 F.2d at 660-61; *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 200 (7th Cir. 1988) (discussing method to determine fair value of contingent liabilities); *Grove Peacock Plaza, Ltd. v. Resolution Trust Corp. (In re Grove Peacock Plaza, Ltd.)*, 142 B.R. 506, 515 (Bankr. S.D. Fla. 1992); *Pembroke Dev. Corp. v. Commonwealth Savings & Loan Ass'n, (In re Pembroke Dev. Corp.)*, 124 B.R. 398, 401 (Bankr. S.D. Fla. 1991); *Hargrave v. Boehmer (In re F.H.L., Inc.)*, 91 B.R. 288, 294 (Bankr. D.N.J. 1988).

> creditors place a value of less than $5 million on its commitments. Nonetheless, Debtor is insolvent. Against assets of $5 million, there are claims of $12 million.

*Id.* at 660

Travellers' bankruptcy court citations are not helpful to its position. *Grove Peacock Plaza, supra*, contains no discussion of, but merely cites *Pembroke Development Corp., supra*, for the proposition that "[a] debtor is insolvent for preferential purposes when the fair value of its liabilities exceeds the fair value of its assets." 142 B.R. at 515. *Pembroke* also contains no discussion of the proposition, merely citing *F.H.L. Inc., supra*, as authority for the statement. 124 B.R. at 401. *F.H.L. Inc.*, in turn, contains no discussion of the proposition, merely citing *In re Camp Rockhill, Inc.*, 12 B.R. 829, 833 (Bankr. E.D.Pa. 1981). 91 B.R. at 294. *In re Camp Rockhill, Inc.* not only does not discuss the proposition, it does not even use the term "fair value" in reference to liabilities. 12 B.R. at 832.

*Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635 (3d Cir. 1991), *cert. denied*, 112 S.Ct. 1476 (1922) also involved a consideration of the assessment of a debtor's portion of an obligation shares by other obligors. Travellers' reference to the court's statement that "[t]he debtor's assets and liabilities are tallied at fair valuation" is taken out of context and I do not find that *Mellon Bank* supports Travellers' position here.

The plain wording of § 101(32) does not support Travellers' position. The test is whether "the sum of such entity's debts is greater than all of such entity's property, at a fair valuation." Had Congress intended the meaning ascribed by Travellers, it could have easily drafted language to so state. The section could have read: "the sum

of such entity's debts, at a fair valuation, is greater than all of such entity's property, at a fair valuation," or "at a fair valuation, the sum of such entity's debts is greater than all of such entity's property." As expressed in C. Fortgang and T. Mayer, *Valuation in Bankruptcy*, 32 UCLA LRev. 1061, 1094-95 (1985), the Bankruptcy Code

> provides for numerous valuations of assets, but aside from requiring the estimation of an unliquidated claim, the Code does not provide for valuation of liabilities at all. The interest rate and maturity of a claim do not affect its initial allowed amount. Instead, all unmatured principal amounts are accelerated, and every claim is allowed in the full face amount of its liability. Thus, a debtor's 5% debenture due in 1995 is allowed at par though it may have been traded at a discount prior to the petition
> . . . .

The discussions in *Covey, Xonics* and *Mellon Bank* involving valuation of multi-obligor claims fall within the category of estimation of unliquidated claims. They have no application here to the TWA publicly traded debt obligations.

Travellers' argument that both assets and debts should be "fairly valued" produces an anomalous result. If holders of claims are fully informed of the debtor's affairs and the asset values are less than the face amount of the claims, they would never value their claims at more than the value of the assets. Likewise, the fully informed debtor would never be willing to pay claimants more than claimants would be willing to take. Thus, the value of the claims would never exceed the value of the assets and insolvency could never occur.

Travellers' argument for fair valuation of debt is limited to TWA's publicly traded debts because Travellers had no basis for determining how the holders of non-publicly traded debt valued their holdings. But how does one distinguish in principle between valuing publicly traded debt and private debt? Surely the holders of the non-publicly traded debt also viewed the value of that debt at substantially below the face amount. Why should a distinction turn on the problem of how to gauge the holders' perception of value? Why not do a survey, or pole the holders of the non-publicly traded debt? Why not also survey, or pole the holders of trade debt? The short answer is that it does not make any difference what the creditors believe they can recover. They initially bargained with the debtor to recover the face amount of their claim and I believe that is what § 101(32) contemplates. When TWA finally had its plan of reorganization confirmed, the amount of "hit" which the debt holders took was not calculated on the basis of their perception of debt's value, i.e., likely recovery. It was calculated on the basis of the face amount of the debt without regard to whether it was publicly traded.

Travellers seeks to rationalize its valuation of TWA's publicly traded debt on the grounds that (a) in 1990 and early 1991 TWA purchased substantial amounts of some of its publicly traded debt at deep discounts, and (b) prepetition TWA reached agreements with groups of public note holders to eliminate approximately $1 billion of debt. With respect to its market purchases, TWA responds that the subordination provisions of its trust indentures prohibited such market purchases and that in June 1991 senior note holders had obtained an injunction against TWA's market purchases of subordinated debt. Travellers, in turn, argues that TWA could effect market purchases of senior obligations before those of subordinated ones. I

will not attempt to resolve the interplay among the various provisions of TWA debt instruments and what TWA could or could not accomplish in terms of additional market purchases of its debt. As a practical matter, I find it unrealistic to believe that, given its financial condition in November 1991 and its announced journey to the bankruptcy court, TWA could have embarked upon a program of spending hundreds of millions of dollars to retire public debt by market purchases. As of November 4, 1991, TWA's cash and cash equivalents were approximately $400 million and it had a large working capital deficit; to conserve its cash position it was withholding payments to creditors of approximately $162.2 million; it was losing money on operations at the rate of $1 million per day; substantially all of its debt obligations were in default; it had been engaged in negotiations for months with its creditors to do a "pre-packaged" Chapter 11 reorganization; and it had effectively announced to the world that it could not continue to operate absent a substantial capital restructuring. Even assuming that TWA could (a) commit a major portion of its then cash position to debt purchases, (b) effect an orderly liquidation of selected assets to raise additional millions of cash for such purchases and (c) effect an orderly liquidation of other assets to meet its continuing operating deficits in order to continue normal operations, I find it inconceivable that creditors other than public debt holders would stand by and watch such grand scale selective payments of debts. TWA had already announced that it was headed to the bankruptcy court. If TWA were not forced to file a voluntary petition, an involuntary petition surely would have intervened. Consequently, I reject Travellers' valuation of TWA's publicly traded debt as being based on assumptions which ignore the realities of TWA's financial condition.

Travellers' public debt valuation is also premised on the assertion that prior to its Chapter 11 petition TWA had reached an agreement with groups of public note holders to eliminate approximately $1 billion of debt. The effect of this "agreement" on the valuation process is argued repeatedly by Travellers throughouts its briefs. I reject this argument. Contrary to Travellers' assertion, the debt restructuring was not the subject of a binding agreement prior to the filing of the petition on January 31, 1992. In its July 30, 1991 press release, TWA clearly indicated that the $1 billion savings resulting from the debt restructing was to be accomplished through a "prepackaged" reorganization plan to be filed in early 1992. In July 1991 TWA reached a preliminary agreement with certain groups of debt holders to effect the reduction. The October and November 1991 press releases likewise referred to the restructuring as part of a proposed 1992 reorganization plan. On January 21, 1992, TWA entered into a term sheet with certain of its debt holders. That term sheet, signed by no one, is labeled "Draft of January 21, 1992." Only certain elements of the term sheet found their way into the Plan approved by the Court on August 11, 1993. Thus, there was no pre-petition debt reduction of $1 billion, nor was there a binding agreement for the creditors to accept that reduction. As of November 4, 1991, there was a proposed $1 billion reduction of debt as a part of a proposed pre-packaged plan to be implemented in a yet to be filed Chapter 11 case. Presumably, the market trading prices were responding to the "write-downs" which were to be effected by a plan to be proposed in a filing to be made. However, as of November 1991, there had not been a reduction of debt, or an agreement for a reduction of debt, which could support an argu-

ment that TWA's public debt was only a fraction of its face value.

Travellers' market price valuation theory is also premised on a basic assumption, namely, that such a purchase program by TWA would be nondisruptive to the market. That assumption ignores the market forces. An informed public market would react to purchases and raise the asking prices. This in turn would increase the purchase price, i.e., value, of the debt. Even if TWA were a financially stable company, which it clearly was not, at some point in the bidding process it would have to stop its purchases. One could speculate almost endlessly—based on numerous scenarios about available cash, operating conditions, sales of assets to raise cash, etc.—as to when market forces would cause the purchase program to stop. Such speculation only underscores why Travellers' basic assumption is not a workable proposition.

Based upon my view of the law as to the meaning of debt for purposes of § 101(32). I find TWA's debt instruments obligations to be $1,776,752,000 as of November 4, 1991.

*Aircraft Lease Obligations*

TWA's October 31, 1991 balance sheets shows aircraft lease obligations of $813.6 million. This liability reflects capitalized leases, not operating leases. The balance sheet does not list a liability figure for operating leases, although TWA's December 31, 1991 Form 10-K disclosed future minimum operating lease payments of $881.2 million.

In his report, TWA's accounting expert relied upon management's estimate of liquidated damages of $595 million for both operating and capitalized leases and suggested a range of liability between the $595 million esti-

mate and the $813.6 million book figure for the capitalized leases.

Travellers' accounting expert did not include in his calculations any liability for operating lease obligations because he assumed that either (a) the Global values assigned to flight equipment leasehold interests are equivalent to the operating lease liability, or (b) the Global values assigned to the remaining leasehold interests are net of lease obligations (i.e., the buyer assumes the lease obligation).[38] I find this to be a rather sweeping assumption without factual foundation. While Travellers' expert estimated a $430 million operating "leasehold obligations not ascribed additional value," he did not add to or subtract from, or otherwise recalculate, the capitalized lease obligation shown on the balance sheet at $813.6 million. DX 72.

Since I do not accept Travellers' analysis, based as it is on an unacceptable assumption, I accept the only probative evidence of the amount of these unliquidated liabilities, management's estimate of $595 million as the amount of the aircraft lease obligations for both capitalized and operating leases.

*Pension Plan Obligation*

TWA's accounting expert presented a range of $219.4 million to $576 million for TWA's pension plan liability. While Travellers' expert's testimony on this issue is confusing, it appears that Travellers agrees that the minimum pension liability is $219.4 million. To the extent that Travellers disagrees, given the confusion in Travellers' evi-

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[38] This is another example of the fact that, contrary to its post-trial briefs argument, Travellers' evidence reflects consideration of converting assets to cash to pay creditors.

dence on this point, I find TWA's evidence on the point to be persuasive and I therefore conclude that TWA's minimum pension liability at November 4, 1991 was $219.4 million.

The $576 million high end for TWA's pension plan liability is based on an assumed termination of the pension plan. The figure is derived from information furnished by TWA's actuarial consultant. Based on a proof of claim filed by PBGC, TWA argues that the pension plan obligations could be as high as $1.124 billion. Since the PBGC proof of claim was not tested in this adversary proceeding, I accord it no weight in deciding the issue before me.

Travellers argues that the $576 million figure should be disregarded as it is based on a termination of the pension plan resulting from TWA's cessation of business, which is inconsistent with a going concern valuation. Because of the position I take here regarding fair valuation, i.e., an orderly sale of assets to pay creditors' approach. I believe that the plan termination scenario is a correct one and the pension plan liability should reflect it.

Travellers also argues that the $576 million figure is based on an unreasonably low 8% discount rate. While TWA's accounting expert asserted that $576 million is a "conservative" estimate, Travellers notes that TWA's actuarial consultant estimated TWA's termination liabilities while assuming six different discount rates and that the $576 million estimate is based on the lowest rate (8%) used by the actuarial consultant. The range of discount rates used by the actuarial consultant was from 8% to 13%, which produced a range of liability of $576 million to $195 million. My reading of the actuarial report suggests that the 8% discount rate is neither conservative nor realistic. While the parties furnished no guid-

ance on this point, I believe a more appropriate discount rate would be 10%. According to the actuarial report, this produces a pension plan liability of $401 million. I therefore find the pension plan obligation of TWA on November 4, 1991 to be $401 million.

*Medical/Dental Benefits Obligation*

While the parties do not disagree on the $400 million liability for medical and dental benefits, the matter is in dispute because Travellers asserts that recording this liability creates a $400 million asset which thereby offsets the liability. TWA argues that an asset is not created by the recording of the liability.

The dispute centers on the application of the Statement of Financial Accounting Standard No. 106 ("FAS 106"). TWA, like many other businesses, made commitments over the course of many years, through collective bargaining agreements or otherwise, to provide medical and dental payments for retired employees. TWA, like many other businesses, accounted for these obligations on a pay-as-you-go basis, recording only current liabilities for the ensuing year's obligation. Because of the accounting profession's view that these substantial liabilities were not properly reflected on companies' balance sheets, FAS 106 was adopted. It requires that the actuarially determined liability be calculated. This calculated obligation represents the earned portion of the present value of estimated future benefits which a company's employees are entitled to receive. TWA and Travellers agree that on November 4, 1991 that obligation amounted to approximately $400 million.

According to TWA, FAS 106 allows TWA to recognize the $400 million obligation in either of two ways. One method provides that the full amount of the obligation

is recorded with a corresponding charge to earnings. The other method allows a company to record the obligation incrementally over the average remaining service lives of its employees, not to exceed 20 years. In implementing FAS on January 1, 1993, TWA elected the second method.[39]

Travellers' accounting expert was of the view that pursuant to FAS 106 and GAAP, the acknowledgment of the $400 million liability required a corresponding debit entry to the asset side of the balance sheet which he labeled "Unrecognized post-retirement benefit transition obligation." DX 72, p. 5. While I am not persuaded by Travellers argument, it is not necessary for me to decide this issue on the basis of interpreting FAS 106 or GAAP procedures. The insolvency determination before me is not dictated by methodologies of FAS 106 or GAAP. Indeed, as noted above, GAAP does not permit the reflection of assets at fair value.

The apparent purpose of FAS 106 is to cause companies to acknowledge a known and quantifiable liability. TWA did that and Travellers agrees with it. The question that remains is; what value is it to TWA to have that liability. It is clearly not a saleable "asset" and it has no market value. Given the orderly sale of assets scenario which I find applicable to this case, I conclude that having the liability has no value to TWA which can be considered an asset in the determination of TWA's insolvency.

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[39] Following its emergence from bankruptcy in November 1993, as a result of "fresh start" reporting requirements, TWA was required to accrue the full $400 million liability, which resulted in a corresponding charge against earnings.

*Contingent Liabilities*

TWA's accounting expert calculated certain contingent liabilities in the amount of $634.8 million. These consist of $138.8 million payable to two of TWA's unions; $214.8 million for severance payments pursuant to contractual obligations, including collective bargaining agreements and related contracts, $33.1 million of COBRA obligations; and approximately $248.2 million in wind down expenses. These liabilities would accrue as a result of TWA cessation of its operations.

Contingent liabilities should be included in determining "the sum [of the debtors] debts" pursuant to § 101(32).

> A "debt" is defined as liability on a claim. 11 U.S.C. § 101(11). A claim includes a right to payment, even if it is contingent, unmatured, or not reduced to judgment. 11 U.S.C. § 101(4)(A). Since claims may be disputed or contingent, disputed or contingent liabilities must be included in determining total indebtedness for purposes of determining insolvency.

*In re Sierra Steel, Inc.*, 96 B.R. 275, 279 (9th Cir. BAP 1989). The amount of the contingent liability to be taken into account as a "debt" is determined by "the probability that the contingency will occur and the liability will become real." *Id.* at 279 (citing *Xonics Photochemical*, 841 F.2d at 200).

Because TWA had publicly announced in July 1991 that it could not continue to operate absent a substantial compromise of its debt obligations, TWA takes the position that the absence of such a compromise would result in a cessation of operation and a termination of its business. The remotely contingent liabilities would then become fixed obligations. Travellers contends that to

include such contingent liabilities is contrary to the going concern valuation required by § 101(32). Given my position on the need to apply an orderly sale of assets to pay creditors approach in this case, I disagree. If TWA were required to wind down its operations and convert non-cash assets to cash in a 12 to 18 month period, its operations would obviously terminate and the liabilities contingent on that event would then become fixed.

Travellers further argues that GAAP provides that neither accrual nor disclosure of such contingent liabilities is necessary if their occurrence is remote. Since TWA's financial statements filed with the SEC did not accrue or disclose these contingent liabilities, then, according to Travellers, TWA's position can be accepted only if one assumes that TWA filed a series of false SEC reports. The problem with this argument is that the SEC financials were prepared on a GAAP basis on the *assumption* that TWA would continue as a going concern. As noted above, TWA's accountants expressed substantial doubt as to whether the going concern assumption could be sustained. Indeed, they and management, made it clear that absent a major capital restructuring TWA could not continue as a going concern. Of course, the major capital restructuring was effected in August 1993 following the Chapter 11 filing in January 1992. Absent that, termination of business scenario was likely to occur. Therefore, I find that the SEC filings not in conflict with the testimony supporting the conclusion that the contingent liabilities should be counted.

Travellers notes that TWA stated in a number of pre-petition press releases leading up to the petition filing that TWA would continue to conduct business as usual and continue normal operations. I attach no significance to such press release statements. Public pronouncements

of optimism by management when embarking on a Chapter 11 filing are a normal part of public relations. Chapter 11 debtors never say on the eve of filing that they may not be able to reorganize and therefore we may have to liquidate. Public perception of availability, convenience and safety are absolutely critical in the airline industry, and such a candid announcement by an airline would sound the death knell for the company.

I agree in principle that these contingent liabilities should be counted. While I note that the total of $634.8 million includes $248.2 million of wind down expenses, based on "preliminary estimates," since Travellers did not contest the calculation, I will accept that figure on the basis of the only evidence before me on the point.

*Taxes*

TWA estimated a tax liability of up to $370 million. Travellers estimated a tax liability of $949.7 million. Travellers' higher tax liability, of course, reflects the much higher asset values for which it argues. Since the asset values which I have found are higher than those argued for by TWA, I conclude that the tax liability would be at least $370 million.

*Other Liabilities*

In addition to the major categories of liabilities and the tax liability discussed above, TWA's balance sheet reflected a number of obligations as to which the parties' differences were within a limited range. Because of the different labeling used by the parties in listing these, it is impossible to do a detailed comparative analysis. For purposes here, I will adopt Travellers' numbers for these other liabilities. They aggregate $947.4 million. As shown on Travellers' Exhibit 72, these include Accounts and intercompany payables—$270 million; Advance ticket sales—

$272.3 million; Employee compensation and vacation–$177.6 million; Other current liabilities–$3.9 million; Accruals–other–$127.5 million and Long-term–other–$96.1 million.

*Summary of Debts*

Based on the above described analysis, I conclude that on November 4, 1991, TWA's debts aggregated as follows:

| | (000) |
|---|---|
| Debt Obligations | $1,776,752 |
| Aircraft lease obligations | 595,000 |
| Pension plan obligation | 401,000 |
| Medical/Dental benefit obligation | 400,000 |
| Contingent liabilities | 634,814 |
| Other obligations | 947,381 |
| Taxes | 370,000 |
| | $5,124,947 |

With TWA's property having a value of $3,125,811,000, it is clear that TWA was insolvent on November 4, 1991.

## SUMMARY CONCLUSION ON INSOLVENCY

As I view this matter, the category by category determination of asset values and the assessment of liabilities as discussed in detail above produces a conclusion of insolvency which one would logically reach based on TWA's critical financial situation in November 1991. Unlike many pre-petition situations where the debtor's slide toward bankruptcy is not widely perceived or thought to be imminent, or where the filing is precipi-

tated by adverse events occurring after the disputed transfer, in this case the fact that TWA was headed for the bankruptcy court was a matter of public knowledge for many months prior to the subject transfer. Furthermore, it was a matter of public knowledge that TWA's operations could not, on a long-term basis, service its debt. Large blocks of debt holders confirmed that fact by agreeing to work with TWA to effect a major debt restructuring in which the debt holders would give up claims aggregating $1 billion. As I see it, in November 1991 there were only two possibilities: (1) TWA could file for Chapter 11 (or do an out of court restructuring) and salvage its business by having the creditors take a major "hit" along the lines of the preliminary pre-packaged deal; or (2) it could have let the creditors dismantel the company and take foreclosure sale values for a greater "hit". In either event, it was a foregone conclusion that the creditors were going to receive substantially less than a 100% recovery. Nevertheless, Travellers argues that TWA was merely experiencing a short-term liquidity problem and Travellers' expert's appraisal of the asset values shows that the creditors were foolish in accepting less than a 100% recovery on their claims. Travellers' view of the situation is fundamentally at odds with how informed businesspersons were viewing it in November 1991. I believe the informed businesspersons were, in effect, acknowledging that TWA's liabilities exceeded the value of its assets at fair valuation. I find that that market based judgment supports the conclusion I reach based on the analysis discussed above.[40]

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[40] I illustrate this point with specific numbers as follows. According to Travellers, the value of TWA assets was $5,742,-143,000 (excluding the $965 million value for aircraft on order)

[footnote continued]

I make one final observation. In contrasting Travellers' position that the value of assets exceeded the liabilities by more than $1.7 billion with the fact that under the Plan TWA's shareholders received nothing and TWA's general unsecured creditors received only 20% of their claims, TWA asks: if Travellers is to be believed, then what happened to this huge reserve of alleged excess value? Pl. Br. 1. Travellers responds that that value was distributed to TWA's creditors and employees in the form of stock of the reorganized company. Def. Reply Br. 1. I do not find this response very helpful to Travellers' position. Indeed, I believe it undermines their position. First, it is no answer to the issue raised in a preference proceeding that whereas the target creditor received cash it is okay because the other creditors received stock. That is not what the creditors bargained for when they extended credit to the debtor, and the purpose of § 547(b) is to ensure that all similarly situated creditors are treated equally. Second, the value of what TWA's unsecured creditors received in stock (and notes) was substantially less than the amount of their claims.

---

and TWA's total liabilities were $3,992,969,000 (excluding the $965 million liability associated with the aircraft on order). If publicly traded debt were counted at face value rather than on the basis of market quotes, the liability figure increases by $927,925,000 ($1,237,494,000 - $309,519,000), bringing the total liabilities to $4,920,894,000. Thus, the value of the assets still exceeds the liabilities. Yet, according to Travellers' calculations, the aggregate face amount of publicly traded debt of $1,237,444,000 (excluding the original issue discount) was only worth $309,519,000, a 75% discount. Why would the market so severely discount the value of TWA? The answer, of course, is that the market did not value TWA at anywhere near Travellers' figure. I find the market's assessment was one of insolvency.

## APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

Case No. 92-115

In re
TRANS WORLD AIRLINES, INC.,

Debtor.

---

Adversary Proceeding No. A-92-28

TRANS WORLD AIRLINES, INC.,

Plaintiff,

OFFICIAL UNSECURED CREDITORS' COMMITTEE,

Plaintiff-Intervenor,

v.

TRAVELLERS INTERNATIONAL A.G.,

Defendant.

### JUDGMENT

Plaintiff Trans World Airlines, Inc. ("TWA"), as debtor and debtor-in-possession in the above-captioned Chapter 11 case, commenced this Adversary Proceeding against Defendant Travellers International A.G. ("Travellers"), to avoid and recover as a preferential transfer pursuant to 11 U.S.C. §§ 547(b) and 550 the November 4, 1991

transfer of a cash deposit in the amount of $13,693,-101.42 ("Cash Deposit") made by TWA to the Clerk of the United States District Court for the Southern District of New York in his capacity as depositary in the action styled *Travellers International A.G., a Swiss corporation and Windsor, Inc., a Missouri corporation, Plaintiffs v. Trans World Airlines, Inc., a Delaware corporation, Defendant,* Docket No. 88 Civ. 1484 (RJW) (the "SDNY Action"). The Cash Deposit was deposited by the Clerk of the United States District Court for the Southern District of New York in the interest-bearing Court Registry Investment System account.

The Official Unsecured Creditors' Committee in TWA's above-captioned Chapter 11 case, Plaintiff-Intervenor, intervened in this Adversary Proceeding as a party plaintiff and pursuant to 11 U.S.C. §§ 547(b) and 550 sought avoidance and recovery of the Cash Deposit for and on behalf of TWA.

This Adversary Proceeding came on for trial beginning on February 14, 1994. Based upon the evidence adduced at the trial, the stipulation, submissions and argument of counsel for the parties and for the reasons, findings and conclusions set forth in the Court's Opinion dated November 30, 1994, it is hereby ordered that final judgment in favor of Plaintiff and Plaintiff-Intervenor and against Defendant is entered pursuant to Federal Rules of Bankruptcy Procedure 7054 and 9021 as set forth herein:

It is ORDERED, ADJUDGED, DECLARED and DECREED that:

1. The transfer of the Cash Deposit is an avoidable preference satisfying each of the requirements of 11 U.S.C. § 547, including without limitation § 547(b)(1)

through (5) thereof. Pursuant to 11 U.S.C. §§ 547 and 550, all rights and entitlements in and to the Cash Deposit, and all accrued and accruing interest thereon, vest in and belong to TWA and not Travellers, and TWA shall be and is entitled to recover said property. The Cash Deposit, and all accrued and accruing interest thereon, shall be returned to TWA, and Travellers shall execute and deliver to TWA, or to the United States District Court for the Southern District of New York or to the Clerk thereof, such documents or instruments as may be necessary to effect such return.

2. Travellers and its officers, agents, attorneys, employees, representatives, successors and assigns and all other persons in active concert or participation with Travellers accordingly shall be and hereby are enjoined and restrained (i) from making any claim to the Cash Deposit and any accrued and accruing interest thereon; (ii) from interfering with the return of said property to TWA; and (iii) from seeking to collect, levy, execute, enforce or rely on any judgment against TWA now or hereafter entered in the SDNY Action, except to determine the amount of Travellers' claim, if any, in TWA's above-captioned Chapter 11 case.

3. Plaintiff TWA and Plaintiff-Intervenor The Official Unsecured Creditors' Committee each shall recover their respective costs.

4. Pursuant to Federal Rule of Bankruptcy Procedure 9022, in addition to service of this Judgment on the contesting parties and such other persons as may be appropriate, the Clerk of this Court shall perfect service of notice of the entry of this Judgment on the Clerk of the United States District Court for the Southern District

of New York and on the United States Attorney for the District of Delaware.

Dated: Wilmington, Delaware
December 20, 1994

SO ORDERED:

/s/ Peter J. Walsh
Peter J. Walsh
United States Bankruptcy Judge

## APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 97-7037 and 97-7082

IN RE: TRANS WORLD AIRLINES, INCORPORATED,
*Debtor*

TRAVELLERS INTERNATIONAL AG,
*Appellant/Cross-Appellee*
*in Appeal No. 97-7037*

v.

TRANS WORLD AIRLINES, INCORPORATED;
OFFICIAL COMMITTEE OF
UNSECURED CREDITORS FOR
TRANS WORLD AIRLINES

Trans World Airlines, Incorporated
*Appellant/Cross Appellee*
*in Appeal No. 97-7082*

BEFORE: MANSMANN, NYGAARD
and GARTH, *Circuit Judges*

SUR PETITION FOR PANEL REHEARING

The petition for panel rehearing filed by appellant/cross-appellee, Travellers International AG., in the above-entitled cases having been submitted to the judges who participated in the decision of this court, and no judge

who concurred in the decision having asked for rehearing, the petition for rehearing is denied.

By the Court,

/s/ Leonard I. Garth
Circuit Judge

Dated: MAR 03 1998

DW/CC: JOC LSS
MJ WHS
RAK MJT
DCA

APPENDIX G

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

# VALUATION OF SELECTED ASSETS UNDER NON-DISTRESS SALE

Prepared

for

TRANS WORLD AIRLINES

August 7, 1992

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WORLDWIDE AVIATION MANAGEMENT SERVICE

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[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

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I. Current Market Conditions

II. Economic and Operating Environment of the Air Transportation Industry

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Summary
Valuation of Certain TWA Assets
(in Millions)

| *Asset* | *Sale Value Within 18 Months* |
|---|---|
| Aircraft | 430.6 |
| Spare Engines | 96.1 |
| Spare Parts | 69.0 |
| Slots | 88.4 |
| Gate Facilities | 334.1 |
| Ground Equipment | 29.7 |
| International Routes | 490.2 |
| Maintenance Facilities | 45.1 |
| Total | 1583.2 |
| Discounted to Nov 4, 1991 | 1439.3 |

Note: The sale values shown are the expected realization of theoretical in-use values established as at November 4, 1991.

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Values of TWA Aircraft (November, 1991)
and Sale Value Within 18 months (000)

| Aircraft Type | Number of Aircraft | Theoretical Value Nov. 91 | Sale Value (18 Months) | |
|---|---|---|---|---|
| | | 000s | % | Value 000s |
| **Mortgaged** | | | | |
| B-727-31 | 4 | $4,320 | 55 | $2,376 |
| B-727-200ADV | 16 | 96,400 | 55 | 53,020 |
| B-727-200NA | 4 | 7,600 | 55 | 4,180 |
| DC-9-30 | 2 | 13,400 | 55 | 7,370 |
| MD-82 | 4 | 78,200 | 75 | 58,650 |
| B-767-200 | 4 | 133,200 | 75 | 99,900 |
| B-747-100 | 6 | 90,000 | 75 | 67,500 |
| Total | 40 | $423,120 | | $292,996 |
| **Owned** | | | | |
| B-727-31 | 4 | $4,320 | 55 | $2,376 |
| B-727-200NA | 8 | 15,200 | 55 | 8,360 |
| B-747-100 | 2 | 32,000 | 55 | 24,000 |
| B-747-284B | 1 | 29,900 | 75 | 22,425 |
| L-1011-1 | 2 | 16,000 | 75 | 12,000 |
| L-1011-100 | 2 | 32,500 | 75 | 24,375 |
| Total | 19 | $126,620 | | $93,536 |

*(continued)*

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Values of TWA Aircraft (November, 1991)
and Sale Value Within 18 months (000)

| Aircraft Type | Number of Aircraft | Theoretical Value Nov. 91 | Sale Value (18 Months) | |
|---|---|---|---|---|
| | | 000s | % | Value 000s |
| **Drexel** | | | | |
| B-727-200ADV | 3 | $9,900 | 55 | $5,445 |
| B-727-200NA | 2 | 3,000 | 55 | 2,090 |
| L-1011-1 | 4 | 32,600 | 75 | 24,450 |
| B-747-100 | 1 | 16,100 | 75 | 12,075 |
| Total | 10 | $62,400 | | $44,060 |

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

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Theoretical Assessed Value and Sale Value of
TWA's Spare Engines (Owned, Mortgaged, Drexel)
As of November 21, 1991

| Engine Type | Value Per Engine ½ Life Cond. | Number Owned | Total Value | Sale Value % | Value |
|---|---|---|---|---|---|
| | (000s) | | (000s) | | (Within 18 Months) |
| OWNED: | | | | | |
| JT8D-7B | 400 | 10 | 4,000 | 65% | 2,600 |
| JT8D-9A | 600 | 12 | 7,200 | 70% | 5,040 |
| JT8D-15 | 800 | 1 | 800 | 75% | 600 |
| JT8D-217A | 1,700 | 9 | 15,300 | 85% | 13,005 |
| JT8D-217C | 1,750 | 3 | 5,250 | 85% | 4,463 |
| JT8D-7AH | 1,400 | 4 | 5,600 | 85% | 4,760 |
| JT8D-7R4 | 2,700 | 1 | 2,700 | 85% | 2,295 |
| RB211-22B | 1,250 | 2 | 2,500 | 75% | 1,875 |
| Total | | 42 | 43,350 | 80% | 34,638 |
| MORTGAGED: | | | | | |
| JT9D-7R4 | 2,700 | 6 | 16,200 | 85% | 13,770 |

*(continued)*

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Theoretical Assessed Value and Sale Value of
TWA's Spare Engines (Owned, Mortgaged, Drexel)
As of November 21, 1991

| Engine Type | Value Per Engine ½ Life Cond. | Number Owned | Total Value | Sale Value % | Value (Within 18 Months) |
|---|---|---|---|---|---|
| | (000s) | | (000s) | | |
| DREXEL: | | | | | |
| JT8D-7B | 400 | 8 | 3,200 | 65% | 2,080 |
| JT8D-9A | 600 | 19 | 11,400 | 70% | 7,960 |
| JT8D-15 | 800 | 3 | 2,400 | 75% | 1,800 |
| JT8D-7AH | 1,400 | 12 | 16,800 | 85% | 14,280 |
| RB211-22B | 1,250 | 23 | 28,750 | 75% | 21,583 |
| Total | | 65 | 62,550 | 76% | 47,703 |
| Overall Total | | | 122,100 | 79% | 96,110 |
| Discounted To 11/4/91 | | | | | 87,373 |

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Sales Values of TWA's
Total Spare Parts Inventory
*(Pledged Inventory, International and Other Domestic)*
(in thousands)

| DESCRIPTION | TW | VIU | SALE |
|---|---|---|---|
| EXPENDABLE | | | |
| Active | $135,400 | $148,940 | $17,872 |
| Excess | 20,689 | 20,689 | 828 |
| PIPELINE | | | |
| Active | 70,417 | 56,329 | 3,380 |
| Excess | 2,085 | 2,085 | 418 |
| CAPITAL | | | |
| Active | 184,013 | 204,485 | 46,010 |
| Excess | 4,306 | 4,306 | 484 |
| ALL TOTAL | $416,910 | $436,834 | $68,992 |
| Net Present Value (11/4/91) | | | $62,720 |

The following abbreviations are used above:

TW = TWA's inventory records valuation as of November 1, 1991.

VIU = Value in use

SALE = Valuation in a 12 to 18 month sale.

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TWA SLOTS
Theoretical Assessed Value (November, 1991)
and Sale Value

| Location | Slots | Theoretical Assessed Value (000s) | Sale Value Within 18 Months % | Sale Value Within 18 Months Value (000s) |
|---|---|---|---|---|
| DCA | 30 | $ 24,550 | 75% | $18,413 |
| LGA | 41 | 25,500 | 75% | 18,975 |
| ORD | 40 | 31,700 | 90% | 28,530 |
| JFK | 75 | 22,500 | 100% | 22,500 |
| TOTAL | 186 | $103,650 | | $88,418 |

Discounted to Net Present Value (11/4/91) $80,380

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Value as at November, 1991 and Sale Value of TWA Gates / Leaseholds (Millions of Dollars)

| | *Theoretical Appraised Value (As at Nov. 1991)* | *Sale Value (Within 18 Months)* |
|---|---|---|
| St Louis | 185.5 | 139.1 |
| New York - JFK | 136.6 | 82.0 |
| New York - LGA | 40.1 | 0.0 |
| Washington National | 12.7 | 10.2 |
| Los Angeles | 34.2 | 27.4 |
| San Francisco | 18.2 | 14.5 |
| Boston | 30.3 | 24.2 |
| Detroit | 2.9 | 1.5 |
| Columbus | 4.2 | 2.1 |
| Indianapolis | 2.8 | 1.4 |
| Washington (Dulles) | 14.5 | 10.9 |
| Subtotal | 482.0 | 313.3 |
| Other | 41.6 | 20.8 |
| Total | 523.6 | 334.1 |
| Discounted to present value (Nov 4, 1991) | | 303.7 |

Note: No values are estimated for the ORD gates since, as at November 4, 1991, these were committed to American Airlines as part of the second asset purchase agreement.

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WORLDWIDE AVIATION MANAGEMENT SERVICE

## GROUND EQUIPMENT
## SELECTED VALUES (000)

| Equipment Category | Reported Net Book Value | Adjusted Net Book Value | Sale (18 mos.) | |
|---|---|---|---|---|
| | | | Percent | Value |
| 300 | 508 | 1,447 | 25 | 362 |
| 301 | 545 | 545 | 50 | 273 |
| 310 | 595 | 595 | 25 | 149 |
| 320 | 552 | 755 | 30 | 227 |
| 321 | 3,318 | 3,318 | 30 | 995 |
| 322 | 139 | 139 | 20 | 28 |
| 323 | 3,540 | 3,540 | 30 | 1,062 |
| 324 | 631 | 631 | 20 | 126 |
| 325 | 1,622 | 1,622 | 25 | 406 |
| 326 | 349 | 349 | 30 | 105 |
| 327 | 1,622 | 1,622 | 30 | 487 |
| 328 | 7,371 | 7,371 | 30 | 2,211 |
| 329 | 455 | 455 | 30 | 137 |
| 330 | 1,813 | 1,813 | 30 | 544 |
| 331 | 49 | 49 | 15 | 7 |
| 340 | 18,558 | 18,558 | 20 | 3,712 |
| 341 | 7,452 | 7,452 | 30 | 2,236 |
| 342 | 4 | 4 | 15 | 1 |
| 350 | 23 | 50 | 30 | 15 |
| 351 | 455 | 455 | 30 | 137 |
| 360 | 98 | 161 | 15 | 24 |
| 361 | 281 | 281 | 20 | 56 |
| 362 | 13,128 | 13,128 | 10 | 1,313 |
| 364 | 1 | 1 | 15 | 0 |

*(continued)*

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## GROUND EQUIPMENT
## SELECTED VALUES (000)

| Equipment Category | Reported Net Book Value | Adjusted Net Book Value | Sale (18 mos.) | |
|---|---|---|---|---|
| | | | Percent | Value |
| 365 | 9,995 | 9,995 | 15 | 1,499 |
| 370 | 255 | 386 | 20 | 77 |
| 371 | 44 | 44 | 25 | 11 |
| 380 | 3,052 | 3,052 | 15 | 458 |
| 381 | 0 | 1 | 20 | 0 |
| 382 | 11,485 | 11,485 | 50 | 5,743 |
| 383 | 0 | 23 | 5 | 1 |
| 384 | 0 | 3 | 25 | 1 |
| 386 | 195 | 195 | 25 | 49 |
| 387 | 249 | 316 | 50 | 158 |
| 389 | 1,758 | 1,758 | 30 | 527 |
| 390 | 1,923 | 1,923 | 0 | 0 |
| 391 | 1,044 | 1,044 | 35 | 365 |
| 392 | 1,549 | 1,549 | 25 | 387 |
| Sub Total | 94,658 | 96,113 | | 23,885 |
| New(1) | 8,799 | 8,799 | 65 | 5,719 |
| Other(2) | 371 | 371 | 25 | 93 |
| Total | 103,826 | 105,283 | | 29,697 |
| Discounted | | | | 26,997 |

Notes:

See attached for equipment category codes.

(1) Additional equipment not yet distributed to categories and sub-ledgers for depreciation purposes.

(2) Includes: suspense/clearing items, sales and retirements, and construction (ground equipment) work in progress.

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Theoretical Market Value and Sale Value (thousands)
Of TWA International Routes

| | *Theoretical Value (As at Nov. 1991)* | *Sale Value (Within 18 Months)* |
|---|---|---|
| Paris and Beyond (Excluding STL) | 263,135 | 171,038 |
| U.S. - Italy | 199,543 | 129,703 |
| New York - Lisbon | 26,177 | 17,015 |
| New York - Barcelona | 11,339 | 7,371 |
| New York - Madrid | 101,063 | 65,691 |
| New York - Athens | 35,755 | 23,241 |
| Beyond to Vienna, Istanbul & Moscow | 3,546 | 2,305 |
| St. Louis London | 28,991 | 18,844 |
| St. Louis Paris | 7,621 | 4,954 |
| Baltimore-Philadelphia-London | 76,923 | 50,000 |
| Total | 754,092 | 490,160 |
| Discounted to present value (Nov 4, 1991) | | 445,600 |

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

EXHIBIT A

*Definitions, Terms, and Limitations Relating To The Appraisal Report*

For purposes of this report AVMARK has defined "theoretical value" as the maximum value at which an asset could theoretically be sold in an ideal sale, assuming no time constraint. "Sale Value" or "12 to 18 month sale value" is defined as the price that TWA could attain for assets within 12 to 18 months, assuming a market transaction between a willing buyer and a willing seller, both being informed of the relevant facts and neither being under any compulsion to buy or sell.

The appraised value is based upon AVMARK's knowledge of the industry and use of certain estimates, assumptions or definitions, some of which are more fully described in the attached report. THE VALUES SET FORTH IN THIS REPORT SHOULD NOT BE UTILIZED OUTSIDE THE CONTEXT OF, OR WITHOUT KNOWLEDGE OF THOSE ESTIMATES, ASSUMPTIONS, OR DEFINITIONS.

The appraisal report reflects AVMARK's expert opinion and best judgment based on the information available to it at time of preparation. The appraisal report was prepared by AVMARK for the account of Trans World Airlines, Inc. AVMARK does not have, and does not expect to have, any financial interest in the appraised property, nor is AVMARK privy to any effort to induce a financial transaction, including solicitation of loans or other investments on the basis of this report.

This report is prepared in the context of litigation styled *Trans World Airlines, Inc. v. Travellers International AG*, Adversary Proceeding No. A-92-28, and is for no other context or use.

AVMARK accepts no responsibility for damages, if any, suffered by any third party as a result of decisions made or actions taken based on this report.

This appraisal was prepared for the use of Trans World Airlines, Inc. and, as such, is entitled to confidential treatment by AVMARK, Inc., and will not be provided to other parties without the express consent of Trans World Airlines, Inc.

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APPENDIX H

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

*FINAL DRAFT*

# VALUATION OF SELECTED ASSETS UNDER LIQUIDATION SCENARIO

Prepared

for

TRANS WORLD AIRLINES

November 25, 1991

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P05700

[PLAINTIFF'S EXHIBIT 60]

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

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EXHIBIT A - DEFINITIONS, TERMS AND LIMITATIONS RELATING TO THE APPRAISAL REPORT

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WORLDWIDE AVIATION MANAGEMENT SERVICE

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II. Description of TWA Spare Parts Inventory and Previous Appraisals

III. Economic and Operating Environment of the Air Transportation Industry

IV. Listing of TWA Stations/Gates and Historical Passenger Market

V. TWA Detailed Listing of Property Category Table by Property Category

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[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

*Valuation of Certain TWA Assets (in millions)*

| *Asset* | *Current Fair Market Value* | *Immediate Liquidation (Within 6 months)* |
|---|---|---|
| 69 Aircraft | | |
| Mortgaged | $442.5 | $217.8 |
| Owned | 132.5 | 68.5 |
| Drexel | 65.4 | 33.1 |
| 113 Spare Engines | | |
| Mortgaged | 16.2 | 6.5 |
| Owned | 43.4 | 19.9 |
| Drexel | 62.5 | 21.8 |
| Spare Parts Inventory | | |
| Pledged | 205.8* | 25.9 |
| Other Domestic | 27.7* | 4.4 |
| International | 10.5* | 1.6 |
| All total | 244.0* | 31.9 |
| Slots | 103.7 | 62.9 |
| Gate Facilities** | 575.3 | 275.7 |
| Ground Equipment | | |
| Domestic | 86.5 | 7.3 |
| International | 4.8 | 0.3 |
| Total | 91.3 | 7.6 |
| International Routes | 670.0 | 0.0 |
| Total | $2,446.8 | $743.7 |

* Controlled Sale Value over a period of two or three years.

** Domestic only. International gates are included as part of valuation for international route authority. It is our understanding that the value which attaches to these assets is virtually inseparable from the international air carrier route authority.

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

EXHIBIT A

*Definitions, Terms, and Limitations Relating To The Appraisal Report*

AVMARK, Inc. ("AVMARK") defines "Fair Market Value" (either current or future values) as the price at which we believe the assets would trade between a willing buyer and a willing seller, both being informed of the relevant facts and neither being under compulsion to buy or sell. In the context of our evaluation, the value we have determined as a Fair Market Value is such only when the specific conditions are met.

The appraised value is based upon AVMARK's knowledge of the industry and use of certain estimates, assumptions or definitions, some of which are more fully described in the attached report. CURRENT FAIR MARKET VALUE OR FUTURE FAIR MARKET VALUE SHOULD NOT BE UTILIZED OUTSIDE THE CONTEXT OF, OR WITHOUT KNOWLEDGE OF THOSE ESTIMATES, ASSUMPTIONS, OR DEFINITIONS.

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*(continued)*

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

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P05742

## APPENDIX I

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

1911 North Fort Myer Drive Suite 1000 Arlington, VA 22209
TELEFAX (703) 528-3659 TELEX 90-1770 (703) 528-5610

# VALUATION OF SELECTED ASSETS UNDER LIQUIDATION SCENARIOS

Prepared

for

TRANS WORLD AIRLINES

August 16, 1991

[PLAINTIFF'S EXHIBIT 181]

[DEPOSITION EXHIBIT DEOSARAN 3]

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[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

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VII. THE REMAINING INTERNATIONAL ROUTES. . . . . .36

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[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

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V. TWA Detailed Listing of Property Category Table by Property Category

VI. Current Fair Market Value and Liquidation Value of International Routes - With Comments



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[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

Valuation of Certain TWA Assets (in millions)

| *Asset* | *Current Fair Market Value* | *Immediate Liquidation (Within 6 months)* | *More Orderly Liquidation (Approx. 18 months)* |
|---|---|---|---|
| 71 Aircraft | | | |
| Mortgaged | $441.3 | $221.5 | $309.8 |
| Owned | 115.5 | 58.6 | 81.7 |
| Drexel | 65.4 | 33.1 | 46.2 |
| 113 Spare Engines | | | |
| Mortgaged | 44.1 | 26.3 | 35.2 |
| Owned | 16.2 | 10.5 | 13.8 |
| Drexel | 63.2 | 35.5 | 48.1 |
| Spare Parts Inventory | | | |
| Pledged | 222.8* | 25.2 | 53.8 |
| Other Domestic | 10.3* | 1.5 | 3.2 |
| International | 27.5* | 4.1 | 9.1 |
| All total | 260.6* | 30.8 | 66.1 |
| Slots | 103.7 | 67.8 | 88.1 |
| Gate Facilities** | 575.3 | 275.7 | 386.3 |
| Ground Equipment | | | |
| Domestic | 86.5 | 7.3 | 25.2 |
| International | 4.8 | 0.3 | 1.1 |
| Total | 91.3 | 7.6 | 26.3 |
| International Routes | 670.0 | 335.0 | 435.7 |
| Total | $2,466.6 | $1,102.4 | $1,537.3 |

* Controlled Sale Value over a period of two or three years.

** Domestic only. International gates are included as part of valuation for international route authority. It is our understanding that the value which attaches to these assets is virtually inseparable from the international air carrier route authority.



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[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

EXHIBIT A

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*(continued)*

[LOGO] AVMARK INC.
WORLDWIDE AVIATION MANAGEMENT SERVICE

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# APPENDIX J

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## REPORT ON ASSETS & LIABILITIES *

* Prepared in the context of litigation styled *Trans World Airlines, Inc. v. Travellers International A.G.*, Adversary Proceeding, No. A-92-28, and is for no other purpose, context or use.

[PLAINTIFF'S EXHIBIT 12]

[DEPOSITION EXHIBIT FINN No. 12 8-13-92]

Summary of Assets and Liabilities as of 10/31/91

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| | Bal. Sheet 10/31/91 | Adjustments/ Offsets | Estimated Value | Schedule or Note Reference |
|---|---|---|---|---|
| ASSETS | | | | |
| Cash and Cash Equivalents | 402,373 | | 402,373 | |
| Accounts Receivable-Net | 476,362 | (180,561) | 291,380 | Exhibit 1 |
| Spare parts materials and supplies | 204,051 | | 68,992 | Avmark Report |
| Prepaid Expenses | 49,686 | (12,292) | 0 | Exhibit 2 |
| Other Current Assets and Expenses | 2,091 | (182) | 0 | Exhibit 3 |
| PROPERTY OWNED - NET | | | | |
| Flight Equipment | 631,208 | | 430,592 | Avmark Report |
| Capitalized Spare Parts | | | 96,110 | Avmark Report |
| Prepayments on Flight Equip | 27,996 | | 0 | |
| Land Buildings and Improvements (Facilities) | 138,490 | | 45,091 | Avmark Report |
| Other property and equipment | 97,388 | | 29,697 | Avmark Report |

Assumptions and information contained in Exhibits are integral in understanding the above analysis.

*(continued)*

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Summary of Assets and Liabilities as of 10/31/91

| PROPERTY UNDER CAP LEASES - NET | Bal. Sheet 10/31/91 | Adjustments/ Offsets | Estimated Value | Schedule or Note Reference |
|---|---|---|---|---|
| Flight Equipment | 473,141 | | 0 | |
| Land Buildings and Improvements | 92,943 | | 0 | |
| Other Property and Equipment | 15,373 | | 0 | |
| Investments in other Affiliates | 32,732 | | 32,732 | Note 1 |
| Investment in Getaway | | | 0 | Note 2 |
| Investment in Travel Channel | | 50,000 | 50,000 | Note 3 |
| Investment in Worldspan | 53,778 | 30,260 | 0-84,038 | Note 4 |
| Investment in Pars | 30,441 | (30,441) | 0 | |
| Other Investments and Receivables | 175,702 | (16,000) | 159,702 | Note 5 |
| Other assets and Deferred Charges | 20,432 | | 0 | Exhibit 4 |
| Total Assets Before Off Balance Sheet Items | 2,924,187 | (159,216) | 1,606,669 - 1,690,707 | |

Assumptions and information contained in Exhibits are integral in understanding the above analysis.

*(continued)*

Summary of Assets and Liabilities as of 10/31/91

| Confidential - For Attorney's Use Only | Bal. Sheet 10/31/91 | Adjustments/ Offsets | Estimated Value | Schedule or Note Reference |
|---|---|---|---|---|
| Gates & Slots | 0 | | 439,518 | Avmark Report |
| Routes | 0 | | 440,160 | Avmark Report |
| Total Assets | 2,924,187 | (159,216) | $2,486,347 - $2,570,385 | |
| LIABILITIES | | | | |
| Debt Obligations | 1,590,823 | | 1,776,752 | Exhibit 5 |
| Advance Ticket Sales | 272,306 | (191,161) | 81,145 | Exhibit 6 |
| Trade Payables | 290,520 | (33,080) | 257,440 | Exhibit 7 |
| Employee Related Payables | 209,411 | (845) | 208,566 | Exhibit 8 |
| COBRA Liabilities | 0 | | 33,059 | Exhibit 9 |
| Taxes | 29,619 | 21,220 | 50,839 - 370,000 | Note 6 |
| Worldspan Liability | 27,575 | | 27,575 | Note 4 |
| Frequent Flyer Program | 14,800 | | 14,800 | Exhibit 10 |

**Assumptions and information contained in Exhibits are integral in understanding the above analysis.**

*(continued)*

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Summary of Assets and Liabilities as of 10/31/91

| | Bal. Sheet 10/31/91 | Adjustments/ Offsets | Estimated Value | Schedule or Note Reference |
|---|---|---|---|---|
| Lease Obligations | 813,604 | | 595,000 - 813,604 | Exhibit 11 |
| Pension Liabilities | 112,958 | 106,461 | 219,419 - 576,000 | Exhibit 12 |
| Post Retirement Life Insurance Benefits | 28,016 | | 28,016 | Exhibit 13 |
| Other Deferred Credits | 20,455 | | 0 | Exhibit 14 |
| Post Retirement Medical and Dental | 36,699 | | 436,699 | Exhibit 15 |
| Litigation | 28,200 | | 41,900 | Note 7 |
| Foreign Severance Liability | 0 | 13,623 | 70,291 | Exhibit 16 |
| Foreign Pension Liability | 5,776 | 64,515 | 13,623 | Exhibit 16 |
| Domestic Severance | | | 214,774 | Exhibit 17 |
| ALPA | | | 93,400 | Note 8 |
| IAM | | | 45,400 | Note 8 |
| Wind down Expenses | | | 248,181 | Note 9 |
| Total Liabilities | 3,480,762 | (19,267) | $4,456,879 - $5,351,225 | |
| Deficit | | | ($1,970,532 - $2,780,840) | |

Assumptions and information contained in Exhibits are integral in understanding the above analysis.

Notes

*Assets*

1. Investments in affiliates represents TWA's share of three partnership interests. The partnerships invest in marketable securities. The equity method of accounting is used by TWA to record its share of income or loss produced by the partnership after any adjustments necessary to state marketable securities owned by the partnerships at the lower of cost or market. For this analysis, the value stated on the balance sheet has been utilized as the estimated cash value.

2. For purposes of this analysis, TWA's management has placed a value of no greater than $5 million on TWA's investment in Getaway Vacations both in the U.S. and in the U.K. because the net book value, excluding inter-company accounts receivables and payables, is a deficit of ($5.5 million). Therefore, any cash received would satisfy those third party obligations and no residual value would be available to TWA.

3. On March 9, 1992, the Bankruptcy Court approved the sale of substantially all of the assets of TWA's 97% owned cable programming subsidiary, Travel Marketing Corporation, formerly known as the Travel Channel, Inc., for $50 million, pursuant to an agreement announced by TWA on January 13, 1992.

4. For purposes of this analysis, the value of TWA's investment in Worldspan L.P. (PARS) has been calculated to range between zero and $84,038,000 in accordance with the "Triggering Event" provisions of the Fifth Amended and Restated Limited Partnership Agreement dated as of June 28, 1990 (the "Agreement"). Utilizing the "Purchase Price of Special Call-

ees" described in Section 12.100 of the Agreement. The primary assumptions are as follows:

- A "Triggering Event" as described in Section 5.4 of the Agreement occurs which will result in a sale of TWA's interest in the Worldspan L.P. to one or all of its partners.
- The Worldspan L.P. partners will purchase TWA's 24.9% interest in Worldspan L.P. to realize the $84 million value. It should be recognized that the agreement allows for the partners to purchase TWA's interest at their option. If the partners choose not to exercise their option and no other buyers can be found, the value to TWA could be zero.
- The price per interest point as outlined in Section 5.4(3)(i) of the Agreement is $3,375,000.
- TWA's net liability to Worldspan of $27,575,000 as reflected in the October 31, 1991 balance sheet is assumed to be a continuing obligation of TWA and accordingly has not been eliminated.
- TWA's interest in PARS Service Partnership (PSP) which provides on-line computer services to the Worldspan L.P. Partnership) is assumed to be sold as a part of TWA's partnership interest in Worldspan L.P. without separate or additional consideration.

5. Other investments and receivables represent restricted cash deposits for equipment trust certificate deposits, letters of credit, escrow deposits, workman's compensation liabilities, credit card deposits, lease security deposits, and collateral bonds for foreign ticket purchases. The restricted cash balance has been reduced by $16 million of credit card deposits which have been offset in the accounts payable balance since it is assumed that credit card companies would offset

amounts due to them with the deposits. The remaining value on the balance sheet as of October 31, 1991 has been utilized as the estimated value of this asset in this analysis.

*Liabilities*

6. The October 31, 1991 balance sheet reflects $50 million of taxes payables which include excise, state and local taxes. Based on the proceeds and liabilities reflected in this analysis, the tax liability has been calculated to range between the $50 million (as reflected on the October 31, 1991 balance sheet) and $370 million.

7. TWA's liabilities as of October 31, 1992 include a reserve for litigation. The recorded reserve for litigation as of October 31, 1992 was $28 million, which did not include any amount for the Travellers litigation. This liability has been adjusted to include the $13 million for Travellers. TWA has appealed the judgement in the Travellers litigation.

8. TWA has not prepared a comprehensive wind-down plan. The wind-down costs included in this analysis are preliminary estimates of payroll, occupancy costs and other expenses which would most likely be incurred assuming an orderly cessation of operations over a twelve to eighteen month period.

9. Other liabilities arising from a right to payment contingent upon a cessation of operations include the Airline Pilots Association "(ALPA") Non-Negotiable Promissory note dated October 24, 1988 in the principal sum of $93.4 million (net of profit sharing payments) and the agreement between TWA and The Association of Machinists and Aerospace workers ("IAM") dated December 1985 in the principal sum of $45.4 million (net of profit sharing payments).

Trans World Airlines, Inc.
Accounts Receivable
October 31, 1991
(000's)

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Exhibit 1

| | Note | *Balance 10/31/91* | *Offset/ Adjustments* | *Balance* | *Realization Assumption* | *Value Realized* |
|---|---|---|---|---|---|---|
| US Government | | | | | | |
| GTRs current and other | (1) | $8,094 | ($13) | $8,081 | 100.0% | $8,081 |
| GTRs Unpaid | (2) | 5,554 | 0 | 5,554 | 20.4% | 1,133 |
| Air Mail Comp | (3) | 5,873 | 0 | 5,873 | 100.0% | 5,873 |
| UATP | (4) | 110,286 | (16,543) | 93,743 | 100.0% | 93,743 |
| Getaway | (5) | 38,718 | 0 | 38,718 | 100.0% | 38,718 |
| Outside C C | (6) | 75,325 | (75,325) | 0 | 100.0% | 0 |
| Miscellaneous | (7) | 17,368 | 0 | 17,368 | 100.0% | 17,368 |
| Air Freight | (8) | 15,295 | 0 | 15,295 | 100.0% | 15,295 |
| Travel Agents | (9) | 16,666 | (11,861) | 4,805 | 100.0% | 4,805 |
| TWA Lift Due from OAL's | (10) | 61,521 | (61,521) | 0 | 100.0% | 0 |
| Overseas Accounts | (11) | 46,674 | (5,777) | 40,897 | 100.0% | 40,897 |
| Work-in-process | (12) | 27,059 | (9,521) | 17,538 | 100.0% | 17,538 |
| Other | | 58,513 | | 58,513 | 100.0% | 58,513 |
| Total Receivables | | 486,946 | (180,561) | 306,385 | | 301,964 |
| Allowance for Doubtful Accounts | | 10,584 | | 10,584 | | 10,584 |
| | | $476,362 | ($180,561) | $295,801 | | $291,380 |

*(continued)*

(1) Government Transportation Requests (GTRs) current include air mail contracts, military personnel, and other US government receivables. Collectible with no reserve provision. Currently, the government is holding back certain receivables for potential offsets. Offset represents receivables which existed as of October 31, 1991 which have been held back.

(2) GTRs unpaid. Disputed amounts subject to litigation and appeal. Historically, 40% of balance is potentially rebillable and 51% of rebills are collected. Potential collectable is therefore, 20.4% (40% x 51%). The allowance for doubtful accounts considers the collectability of these receivables.

(3) Includes the amount due from the U.S. and foreign governments for carriage of mail by air over TWA's routes.

(4) Universal Airline Travel Plan (UATP). Corporate travel accounts, generally due 30 days, highly collectable. Offset reflects relative fraction of receivable related to prepaid travel on TWA which is offset against advanced ticket sales liabilities.

(5) Revolving credit for personal travel program with a payment schedule of 18 months.

(6) Outside credit card balance assumes that entire amount and any deposits held are to be offset against advanced ticket sales liabilities.

(7) Miscellaneous receivables, generally previously billed maintenance invoices deemed collectable.

(8) Air Cargo receivables, generally collectable.

*(continued)*

(9) Represents cash amounts due on passenger ticket sales reports from the Area Settlement Plan travel agents. The offset represents commission amounts due to travel agents which participate in the sales development program.

(10) Other general traffic and other airline receivables are related to or subject to clearing house netting. Assumed offset against advanced ticket sales liability.

(11) TWA maintains a separate receivable ledger for international activity. The balance represents the various types receivables primarily general traffic. The offset amount relate to credit card sales and OAL activity similar to the domestic activity discussed in Notes 6 and 10.

(12) Work-in-Process receivables. Assumes that work-in-process for air freight carriers for work in house will be completed at no less than cost, converting WIP receivables to billable amounts. Billable amounts are deemed to be highly collectable as value of equipment held exceeds value of receivable. Offsets were determined in two components: (1) Offsets of $6.0 million represent prepurchased materials for work which may not be performed. Prepaid materials are assumed to be reclassed as spare parts inventory for liquidation purposes. (2) Receivables from other airlines as a result of direct or interline billings of $3.5 million are assumed to offset against the air traffic liability.

Trans World Airlines, Inc.
Prepaid Expenses
October 31, 1991
(000's)

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Exhibit 2

| *Account Description* | *Balance* | *Offsets* | *Adjustments* | *Estimated Value (2)* |
|---|---|---|---|---|
| Prepaid Rent | $4,337 | | ($4,337) | $0 |
| Prepaid Insurance Premium | 5,354 | | (5,354) | 0 |
| Prepaid Insurance Reserve | 1,720 | | (1,720) | 0 |
| Prepaid Traffic Commissions (1) | 12,292 | (12,292) | 0 | 0 |
| Prepaid Rent - Aircraft | 17,592 | | (17,592) | 0 |
| Prepaid Other | 8,391 | | (8,391) | 0 |
| Total | $49,686 | ($12,292) | ($37,394) | $0 |

(1) These prepayments are assumed to be offset against obligations; the remaining prepayments would have no value.

(2) No cash value is assumed to be realized for these assets.

Trans World Airlines, Inc.
Other Current Assets
As of October 31, 1991
(000's)

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Exhibit 3

| *Account Description* | *Balance* | *Offsets* | *Adjustments* | *Estimated Value (2)* |
|---|---|---|---|---|
| District Control Office/ COAO | $327 | | (327) | $0 |
| Special Deposits | 1,245 | | (1,245) | 0 |
| Marriot Credits | 163 | | (163) | 0 |
| Aircraft Injury Reserve | 762 | | (762) | 0 |
| OAL Billing Exceptions | 170 | (170) (1) | 0 | 0 |
| Expense Work Orders in Process | 12 | (12) (1) | 0 | 0 |
| Other Current Assets | (588) | | 588 | 0 |
| Total | $2,091 | ($182) | ($1,909) | $0 |

(1) Other Airline billings and expense work orders in process have been offset against air traffic liabilities. (Exhibit 2A)

(2) No cash value is assumed to be realized for these assets.

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Trans World Airlines, Inc.
Other Assets & Deferred Charges
October 31, 1991
(000's)

Exhibit 4

| *Account Description* | *Balance* | *Adjustments* | *Estimated Value (3)* |
|---|---|---|---|
| Unamortized Debt Expense (1) | $7,800 | ($7,800) | $0 |
| Other Deferred Costs (2) | 9,627 | (9,627) | 0 |
| Long-Term Prepayments (1) | 2,183 | (2,183) | 0 |
| Aircraft Development & Integration Costs (1) | 822 | ($822) | 0 |
| Total | $20,432 | ($20,432) | $0 |

(1) Includes unamortized expenses on debt and capital leases and long term prepayments representing capitalized costs in accordance with Generally Accepted Accounting Principles (GAAP) No cash value is assumed to be realized for these assets.

(2) Other deferred costs include Inter-Regional Invoices (IRI's) which are used to transfer activity between TWA divisions. No cash value is assumed to be realized for these assets.

(3) No cash value is assumed to be realized for these assets.

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Exhibit 5

Trans World Airlines, Inc.
Debt Obligations
As of October 31, 1991
(000's)

| *Account Description* | *Estimated Claim Value* |
|---|---|
| Current Maturities of Long-Term Debt | $1,384,034 |
| Interest on Long-Term Debt | 206,789 |
| Unamortized discount on 12% Debenture (2) | 185,929 |
| Total Debt Obligations | $1,776,752 |

1) At October 31, 1991, all of TWA's long-term debt outstanding has been classified as current liabilities due to non-compliance with certain financial covenants. Such non-compliance has resulted in a reclassification of $1,211,738,290 to current maturities.

2) As stated on page F-25 of the 1991 10K, the unamortized original issue discount reflected on the 10/31/91 balance sheet for the 12% Junior Subordinated Debentures due 2001 and 2008 of $104,814 and $81,115 respectively has been added in order to reflect the face value of the obligations.

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Exhibit 6

Trans World Airlines, Inc.
Advanced Ticket Sales/Air Traffic Liability
As of October 31, 1991
(000's)

| *Lead Schedule Page* | *Account #* | *Account Description* | *Balance* | *Offsets/ Adjustments* | *Estimated Claim Value* |
|---|---|---|---|---|---|
| 45 | All | Advanced Ticket Sales | $272,306 | ($191,161) (1) | $81,145 |

(1) Represents air traffic receivables and certain other amounts which are assumed to be offset against air traffic liabilities. See Exhibit 6A for detail.

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Exhibit 6A

Trans World Airlines, Inc.
Air Traffic Liability Offsets
As of October 31, 1991
(000's)

| *Offset Type* | *Amount* | |
|---|---|---|
| Other Airline Receivables | $65,372 | Exhibit 1 (Note 10 & 11) |
| Credit Card Holdbacks | 80,772 | Exhibit 1 (Note 6 & 11) |
| Travel Commissions on Outstanding Ticke | 12,292 | Exhibit 15 |
| Credit Card Deposits | 16,000 | Note 4 |
| Corporate Accounts | 16,543 | Exhibit 1 (Note 4) |
| Other Current Assets | 182 | Exhibit 3 |
| Total | $191,161 | |

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Trans World Airlines, Inc.
Trade Payables
As of October 31, 1991
(000's)

Exhibit 7

| *Lead Schedule Page* | *Account #* | *Account Description* | *Balance* | *Offsets/ Adjustments* | *Estimated Claim Value* |
|---|---|---|---|---|---|
| 46-50 | All | Accounts Payable | $242,402 | ($21,220) (1) | $221,182 |
| 56 | 21255 | Other Accrued Interest | 30 | | 30 |
| 59 | Various | Accrued Expenses | 45,959 | (11,860) (2) | 34,099 (3) |
| 65 | 22931-22935 | Other Non-Current Liabilities | 2,129 | | 2,129 (4) |
| | | Total Trades Payable | $290,520 | ($33,080) | $257,440 |

(1) Represents various transportation, charter, federal, state and local taxes which have been reclassified as taxes. The appropriate accounts have been identified on the Accounts Payable lead sheets.

(2) Sales Development Incentive Commission Obligations which have been offset against travel agent receivables.

(3) Represents various accrued liabilities reflected on the books.

(4) Consists primarily of abandoned (unclaimed) property identified by TWA in areas such as Accounts Payable, Passenger Revenue, Cash Management and Getaway Accounts.

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Exhibit 8

Trans World Airlines, Inc.
Employee Related Payables
As of October 31, 1991
(000's)

| *Lead Schedule Page* | *Account #* | *Account Description* | *Balance* | *Offsets/ Adjustments* | *Estimated Claim Value* |
|---|---|---|---|---|---|
| 51 | All | Accrued Employee Comp & Vac | $177,562 | ($845) (1) | $176,717 |
| 65 | 22904 | Accrued Workers Compensation | 31,849 | | 31,849 |
| | | Total Employee Related Payables | $209,411 | ($845) | $208,566 |

(1) Portion of account number 21973 related to foreign severance. Foreign severance has been separately estimated. See foreign severance liability. (Exhibit 17)

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Exhibit 9

Trans World Airlines, Inc.
COBRA Claim
As of October 31, 1991
(000's)

As of October 31, 1991

| | |
|---|---|
| Total number of employees: | 27,796 |
| Aproximate eligible for retiree benefits: | 8,000 |
| Total eligible for COBRA benefits: | 19,796 |
| 1991 COBRA premiums collected | $1,281 |
| Total 1991 claims paid | 2,780 |
| Net loss (Amounts paid by TWA) | 1,500 |
| Number of Participants as of 10/31/91 | 673 |
| Net loss (Cost) per head per year | $2.23 |
| Cost per head for eighteen month period | $3.34 |
| Liability assuming 50% participation | $33,059 |

The annual cost to the Company for COBRA benefits in 1991 is estimated at $1.5 million. In the event of a cessation of operations or reduction in the work force, those employees of the Company who are not eligible for post retirement health benefits may be eligible to apply for benefits under COBRA. The claim for COBRA benefits has been estimated by the Company assuming that such benefits will be provided to aproximately 50% of the eligible employees for a period of eighteen months at an annual cost per employee of approximately $2,230.

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Exhibit 10

Trans World Airlines, Inc.
Frequent Flyer Claim
As of October 31, 1991
(000's)

As of October 31, 1991

| | | |
|---|---|---|
| Amount accrued in financial statements (under incremental cost method) | $14,800 | Note 1 |

Note 1 Costs are accrued for the Company's FFB program using the incremental cost method. Costs are accrued for the estimated incremental costs of transporting a passenger in an otherwise empty seat.

Trans World Airlines, Inc.
Lease Obligations
As of October 31, 1991
(000's)

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Exhibit 11

| *Lead Page* | *Account #* | *Account Description* | *Balance* |
|---|---|---|---|
| 43,64 | All | Aircraft Lease Obligations | $656,378 |
| 44,64 | All | Other Lease Obligations | 146,040 |
| 54 | All | Interest on Aircraft Leases | 7,746 |
| 55 | All | Interest on Other Leases | 3,440 |
| | | Total Lease Obligations | $813,604 |

1) TWA's lease obligation only includes those leases which have been identified as capital leases. In addition to the capitalized leases recorded, there exists additional obligations for operating leases.

TWA management has estimated liquidated damages to be approximately $595 million for both operating and capitalized leased aircrafts. According to TWA management, this was done comparing liquidated damages as reflected in lease contracts and the fair market value of lease payments as experienced by TWA's management in renegotiating TWA's leases.

The total undiscounted obligations for both operating and capitalized aircraft lease obligations exceeding $1.1 billion. It should be noted that this estimate is based on current lease aggreements and assumes no mitigation. Some of the TWA lease agreements require payment in full for obligations with no requirement for mitigation or allowance for discounting.

Trans World Airlines, Inc.
Pension Liabilities
As of October 31, 1991
(000's)

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Exhibit 12

| *Lead Schedule Page* | *Account #* | *Account Description* | *Balance* | *Offsets/ Adjustments* | *Estimated Claim Value* |
|---|---|---|---|---|---|
| 52 | 2198-7 | Pilots' Retirement Plan | $3,908 | | $3,908 |
| 52 | 2198-9 | Employees' Retirement Plan | (4,135) | | (4,135) |
| 52 | 2199-0 | Def. Tax Pension Liab. - Current | (1,680) | | (1,680) |
| 52 | 2197-7 | Pilot 'B' Plan | 4,103 | | 4,103 |
| 52 | 2198-8 | Other 'B' Plans | 1,159 | | 1,159 |
| 65 | 2250-0 | Min. Pension Liab. FASB - 87 | 114,640 | | 114,640 |
| 65 | 2250-3 | Def. Tax - Pension Liab. (L-T) | (13,860) | | (13,860) |
| 65 | 2250-5 | UK Pension Plan | (4,800) | | (4,800) |
| 65 | 2250-4 | International Division Pension Plan (IDPB | 13,623 | (13,623) (1) | 0 |
| | | | | 120,084 (2) | 120,084 |
| | | Total Pension Liabilities | $112,958 | $106,461 | $219,419 (3) |

*(continued)*

(1) For purposes of this analysis, this account as been reclassified as foreign severance.

(2) The low estimated claim value has been established in accordance with statement of financial accounting standard No. 87. As stated in the 1991 10K on page F-21, in December of 1991 the Company increased the pension obligation by $120,084 million to reflect an appropriate liability under generally accepted accounting principles. The adjustment is made annually and reflects the impact of declining interest rates (discount rate) on this estimated liability value does not assume a termination of the pension plans.

(3) This high estimated liability was prepared by TWA's acturarial consultants assuming that all employees who currently meet the eligibility requirements for various types of benefits became immediately eligible for those benefits and the plans were terminated. The unfunded liability of the plan, assuming the plans are terminated, based on an 8% interest factor was estimated by the actuarial consultants to be approximately $576 million.

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Trans World Airlines, Inc.
Post Retirement Life Insurance Benefits
As of October 31, 1991
(000's)

Exhibit 13

| *Lead Schedule Page* | *Account #* | *Account Description* | *Estimated Claim Value (1)* |
|---|---|---|---|
| 59 | 2198-3 | Employee Benefits - Life/Accident | $1,806 |
| 65 | 2290-5 | Retiree Life Insurance - Current | 19,210 |
| 65 | 2290-0 | Retiree Life Insurance - Non-Current | 11,667 |
| 65 | 2290-1 | Deferred Life Insurance - Taxes | (4,667) |
| | | Total Benefits | $28,016 |

(1) Liabilities with respect to retiree life insurance benefits have been estimated for retired employees and active employees currently eligible to receive such benefits. The liabilities have been valued by TWA's acturarial consultants.

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Trans World Airlines, Inc.
Deferred Credits
As of October 31, 1991
(000's)

Exhibit 14

| *Lead Schedule Page* | *Account #* | *Account Description* | *Balance (1)* | *Adjustments* | *Estimated Claim Value (2)* |
|---|---|---|---|---|---|
| 68 | All | Deferred Credits | $16,556 | ($16,556) | $0 |
| 61 | All | Current Liabilities and Deferred Credits | 3,899 | (3,899) | 0 |
| | | Total Deferred Credits | $20,455 | ($20,455) | $0 |

1) Other deferred credits consisting primarily of unamortized gains associated with certain aircraft sale leaseback transactions are recorded in accordance with Generally Accepted Accounting Principles (GAAP).

2) These deferred credits would not likely represent any payment obligations of the Company.

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Exhibit 15

Trans World Airlines, Inc.
Medical & Dental
As of October 31, 1991
(000's)

| *Account Description* | *Estimated Claim Value* |
|---|---|
| Employee Benefits - Health | $436,699 |
| Total | $436,699 |

The unaudited financial statements as of October 31, 1991 reflect a liability for medical & dental costs (current costs) of $36.7 million. See page 56 of the lead schedules (account # 2198-2).

In December 1990, the FASB issued Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." This Standard requires that the expected cost of providing such benefits be accrued over the years that the employee renders service, in a manner similar to the accounting for pension benefits. The Company previously recorded the cost of such benefits as they were paid. The Standard is required to be implemented for fiscal years beginning after December 15, 1992 and TWA has not elected early adoption of the Standard; however, it is expected to be implemented in conjunction with the fresh start accounting to be applied when TWA emerges

from the chapter 11 proceedings. Adoption of the Standard will not result in any increase in cash expenditures but it will result in additional provisions for expense estimated to be approximately $30 million per annum beginning with TWA's reorganization as a new entity when it emerges from the chapter 11 proceedings. The initial accumulated postretirement benefit obligation will be recorded at its estimated actuarially computed present value as part of TWA's fresh start accounting. This value as determined by TWA's actuarial consultants for employee health and benefit obligations is estimated to be $20 million per year for 20 years or $400,000,000 as stated on page 52 of the 1991 10K.

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Trans World Airlines, Inc.
Foreign Severance
As of October 31, 1991
(000's)

Exhibit 16

| *Lead Schedule Page* | *Account #* | *Account Description* | *Balance* | *Offsets/ Adjustments* | *Estimated Claim Value* |
|---|---|---|---|---|---|
| 51 | 21973 | Accrual for anticipated foreign raise increases | | $845 (3) | $845 |
| 65 | 22908 | Termination Indemnities | 5,776 | 63,670 (1) | 69,446 |
| 65 | 22504 | Interntional Division Pension Plan (IDPB) | | 13,623 (2) | 13,623 |
| | | Total Foreign Severence | $5,776 | $78,138 | $83,914 |

(1) Represents additional foreign termination severance estimated by TWA which is not reflected on the books and would only be realized as a liability arising on a right to payment contingent on cessation of operations.
(2) Represent IDPB reclassified from pension account.
(3) Reclassification from Exhibit 8.

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Exhibit 17

Trans World Airlines, Inc.
Domestic Severance
(000's)

DOMESTIC SEVERANCE LIABILITY:

| | *Eligible # of Employees* | *Estimated Claim Value (1)* |
|---|---|---|
| Pilots | 2,178 | $77,382 |
| Flight Engineers | 620 | 4,164 |
| Flight Attendants | 4,896 | 20,867 |
| Flight Dispatchers | 36 | 1,172 |
| IAM | 9,998 | 65,271 |
| Flight Engineers | 35 | 647 |
| Non Contract | N/A | 45,271 |
| Total Domestic | 17,763 | $214,774 |

1) The potential severance liability for employees was estimated by management in accordance with collective bargaining agreements arising on a right to payment contingent on the cessation of operations.